Actuarial Society of Greater New York

Breakout Session 1:

Focus on FASB Targeted Improvements

Presenters

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Milliman

FASB Targeted Improvements - Contents

Actuarial Society *of* Greater New York

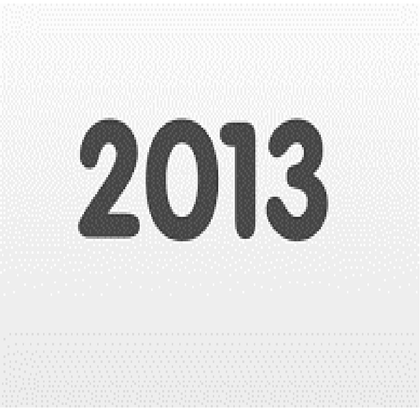
FASB Targeted Improvements Long Duration Contracts

Summary Update

FASB Insurance Contracts Project History

Issued IASB Issues Paper for comment

Decided to join IASB Project



Issued IASB Exposure Draft for comment

Decided to leave IASB Project

Completed project on Short Duration Contracts

Embarked on project on Long Duration Contracts

Overview of FASB Targeted Improvements

- Liabilities for Future Policyholder Benefits
- Market Risk Benefits
- Deferred Acquisition Costs
- Enhanced Disclosures
- Transition
- Effect of Re-deliberations
- Future Project Timeline

Liability for Future Policyholder Benefits

- Under ASC 944:
  - Cash flow assumptions locked in at issue for traditional non-participating, limited-payment and participating contracts
  - Liabilities include provisions for risk of adverse deviation (PADs)
  - An "unobservable" discount rate (or series of rates), typically the insurance entity's expected current and future net investment yields, less a PAD is locked in at issue
    - For certain participating contracts, the discount rate is typically the interest rate guaranteed to the policyholders (e.g., dividend interest rate)
  - Assumptions only "unlocked" if premium deficiency testing exists
  - For Universal life-type (UL) contracts, the determination of whether to establish a liability in addition to an account balance for annuitization, death or other insurance benefits would be performed at contract inception only

Liability for Future Policyholder Benefits

- Under FASB Targeted Improvements for FAS 60 type business:
  - Insurance entity required to update ("unlock") cash flow assumptions at least annually (or more frequently)
  - Net Premium ratio recalculated from inception using unlocked assumptions, the "at-issue" discount rate and capped at 100%
  - Liability measurement may be determined on a seriatim basis or in aggregate at the issue year cohort level
  - Liabilities will <u>not</u> include PADs and will use a retrospective approach with a cumulative catch-up adjustment in the current period
  - Discount rate should be based on market "observable" current upper-medium grade (low credit risk) fixed-income yields and the immediate impact of using updated asset discount rates should be reported in other comprehensive income (OCI)
  - Premium deficiency/loss recognition testing eliminated
- For UL, the determination of whether to establish a liability in addition to an account balance for annuitization, death or other insurance benefits would be performed at least annually
- Premium deficiency remains for Universal Life and participating contracts

Liability for Future Policyholder Benefits - Summary

	Current	Proposed
Cash flow assumptions	Locked-In	Unlocked with changes in P&L
Discount rates	Locked-In	Unlocked with changes in OCI
Reserve method	Net Level	Net Level with NPR capped at 100%
Provision for adverse deviation	Required	None
Loss recognition testing	Required	None

- Discount rate set to upper-medium grade fixed-income instrument yield
- Net premium ratio unlocked to issue (retrospective) for cash flows, but not discount rate
- Contracts may be aggregated by issue year for measurement
- Future policy benefit liabilities for participating contracts should continue to follow existing guidance

Market Risk Benefits - All Benefits to be Valued at Market

Current

GMxBs

- Non-insurance (Fair Value)
- Insurance (SOP 03-1)

Proposed

GMxBs

- Market Risk Benefits (Fair Value)

Market Risk Benefit Criteria (prior 11/1):

- Policyholder directs funds to 1 or more alternatives and receives performance (subject to fees, caps, floors, etc.)
- Insurer provides protection from adverse capital markets performance which exposes insurer to capital market risk.
- Expanded to include general account deposit (or account balance) products (e.g., FIAs)

Changes in Fair Value reflected in P&L

- Except own credit risk reflected in OCI

Deferred Acquisition Cost Assets - Summary

	Current	Proposed
Deferred expenses	Successful Sales Related	No change
Interest accrual	At earned or credit rate	No accrual
Amortization basis	Premium or gross profits / margins	On a Consistent Basis over Expected Life
Loss recognition testing	On reserves net of DAC	None for Non-Par; Retained for UL
Transition	n/a	Use existing (pre-OCI) balance

- DAC will be written off for any actual experience in excess of expected experience regardless of contract profitability

Enhanced Disclosures

Disaggregated roll-forwards from beginning to ending balances of

- liability for future policy benefits
- policyholder account balances
- market risk benefits
- separate account liabilities
- deferred acquisition costs

Disclose quantitative and qualitative information for items affecting measurement such as

- significant inputs
- judgments
- assumptions used in measurement (as of 11/1 required annual only)
- including changes in those items and the effect of those changes on the measurement

Transition

- **DEFAULT: Start with Existing Balances**
- Update future assumptions for cash flows
- Release all AOCI balances

Transition Date →

← **Issue Date**

- **OPTION: Full retrospective application**
- Cumulative catch-up in retained earnings
- Can select for issue year cohorts, but must elect for all subsequent years

Effect of Re-deliberations

	ASU	Current Proposal
Retrospective Update of Reserve	Retrospective	Confirmed Retrospective
Discount rate	High Quality	Upper Medium Quality
Participating Contracts	In Scope with Non-Par	Reserve out of scope but DAC in scope
Market Risk Benefits on non-VA	Out of Scope	In scope
Loss Recognition Test	Not applicable for all products	Still applicable for UL and participating contracts

Topics remaining to discuss:

- Market Risk Benefits (in discussion as of 11/1)
- Presentation and Disclosure (in discussion as of 11/1)
- Effective Date

Future Project Timeline

FASB Targeted Improvements

New Business Examples

FASB Targeted Improvements for Long Duration Products

ASC 944 (Previously known as “FASB 60”)

Non-Par Whole Life Product: Comparison of a New Issue under HGAAP and TGAAP

Product

- Issue Age: 45
- Gender: Male
- Face Amount: 1,000,000
- Annual Gross Premium: 18,000
- Acquisition Cost: 100/ policy
- Commission Structure: 80%, 30%, 10%, 10, 10, 10, 10, 5%, 5, 5....
- Premium Tax: 11.50%
- Maintenance Expense: $35/policy

Assumptions

- Starting Cohort: 1,000 lives
- Investment Yield: 3.54%
- Valuation Rate PAD: -25 bps
- Lapse Rates: 12%, 11%, 9,9,9,7,7,7…
- Mortality: 2001 CSO
- Mortality PAD: 10%

TGAAP Assumptions

- *Discount Rate: 3.50%
- No PADs

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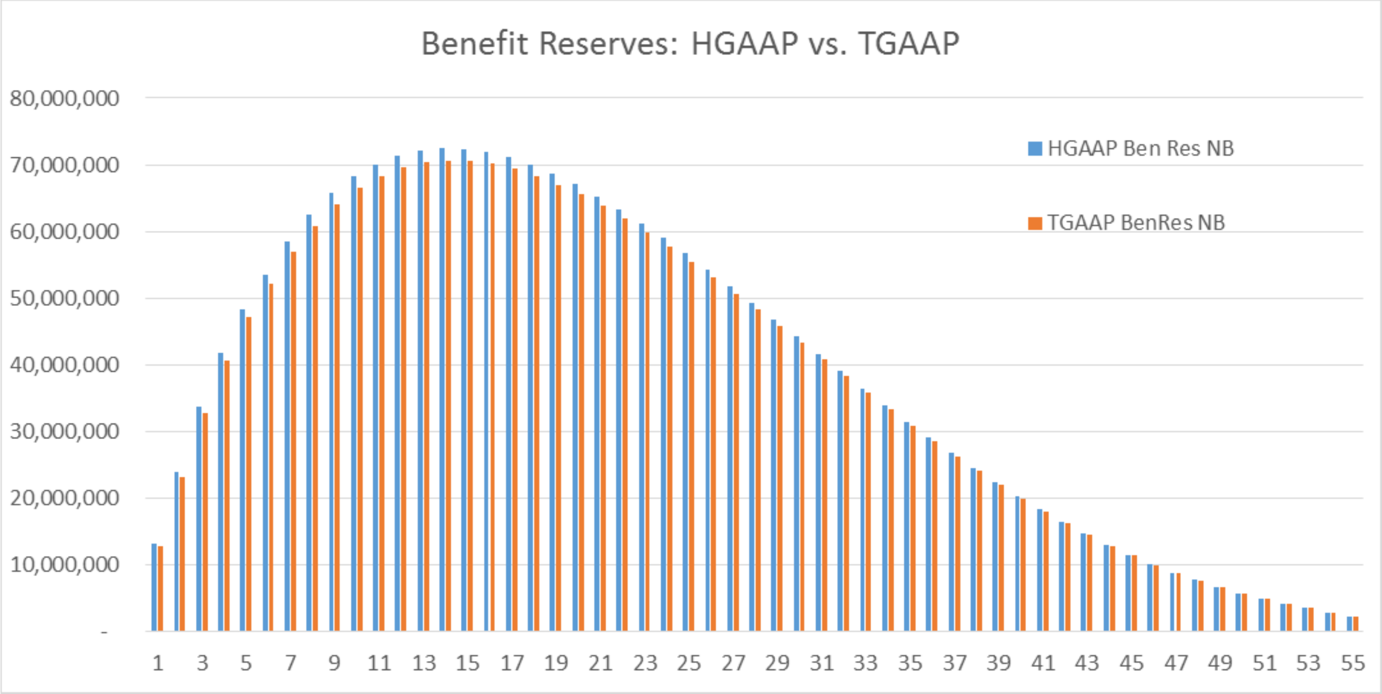
New Business Traditional Life Examples

HGAAP New Business vs TGAAP New Business: No Transition

Benefit Reserves for HGAAP and TGAAP differ due to the following components:

- PADS: HGAAP has 10% mortality PAD and -25 bps discount rate PAD.
- Discount Rate: HGAAP uses a portfolio based discount rate less a PAD (3.54% before PAD). TGAAP uses a single equivalent yield determined from the high quality investment vehicle* yield curve (AA, 3.36%) discount rate.



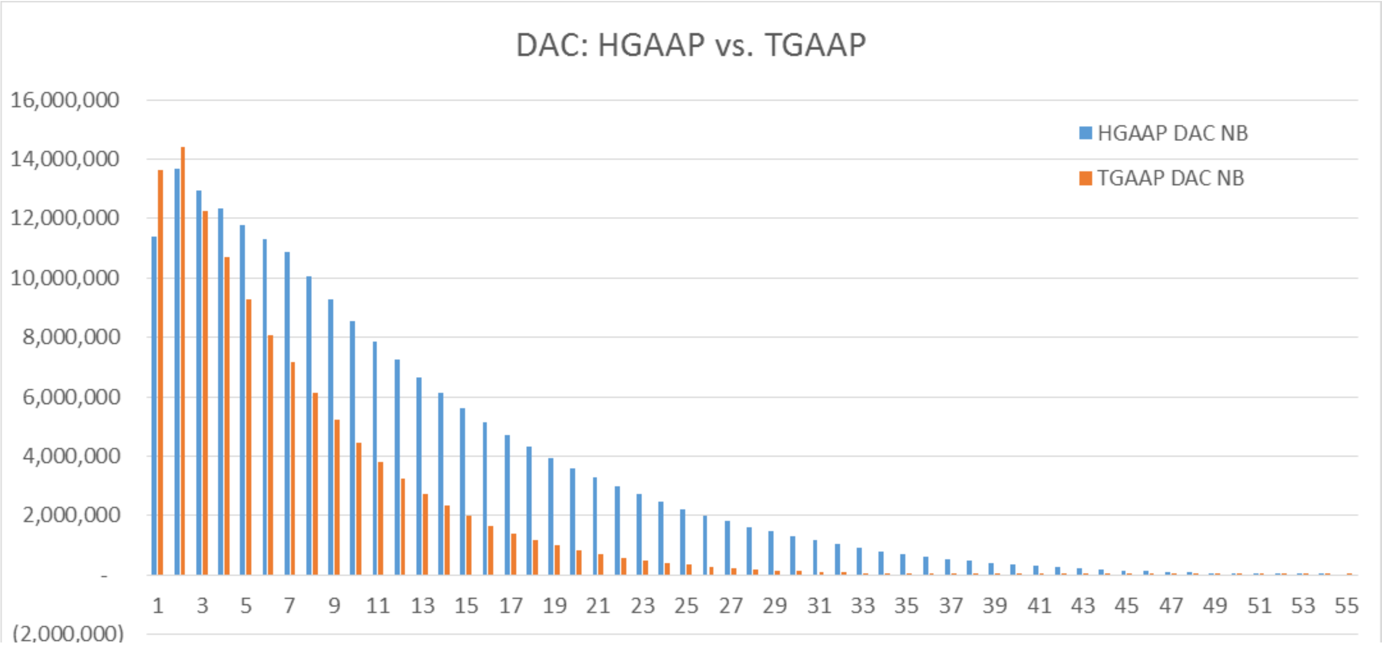
*Note that this example used a high quality investment vehicle. This was not updated for FASB comments dated early October 2017. The results are valid as originally modeled.

New Business Traditional Life Examples

HGAAP New Business vs TGAAP New Business: No Transition

DAC for HGAAP and TGAAP differ due to the following components:

- PADS: HGAAP has 10% mortality PAD and -25 bps discount rate PAD.
- Discount Rate: HGAAP uses a portfolio based discount rate. TGAAP uses no discount rate.
- Basis for Amortization: The HGAAP basis for amortization is the present value of gross premium. TGAAP is the sum of expected face amount.
- Method for Amortization: TGAAP uses a pivot method that increases the rate of amortization each year to reflect new amounts capitalized when incurred. HGAAP uses a constant rate that incorporates all future expected deferrals in the amortization rate.

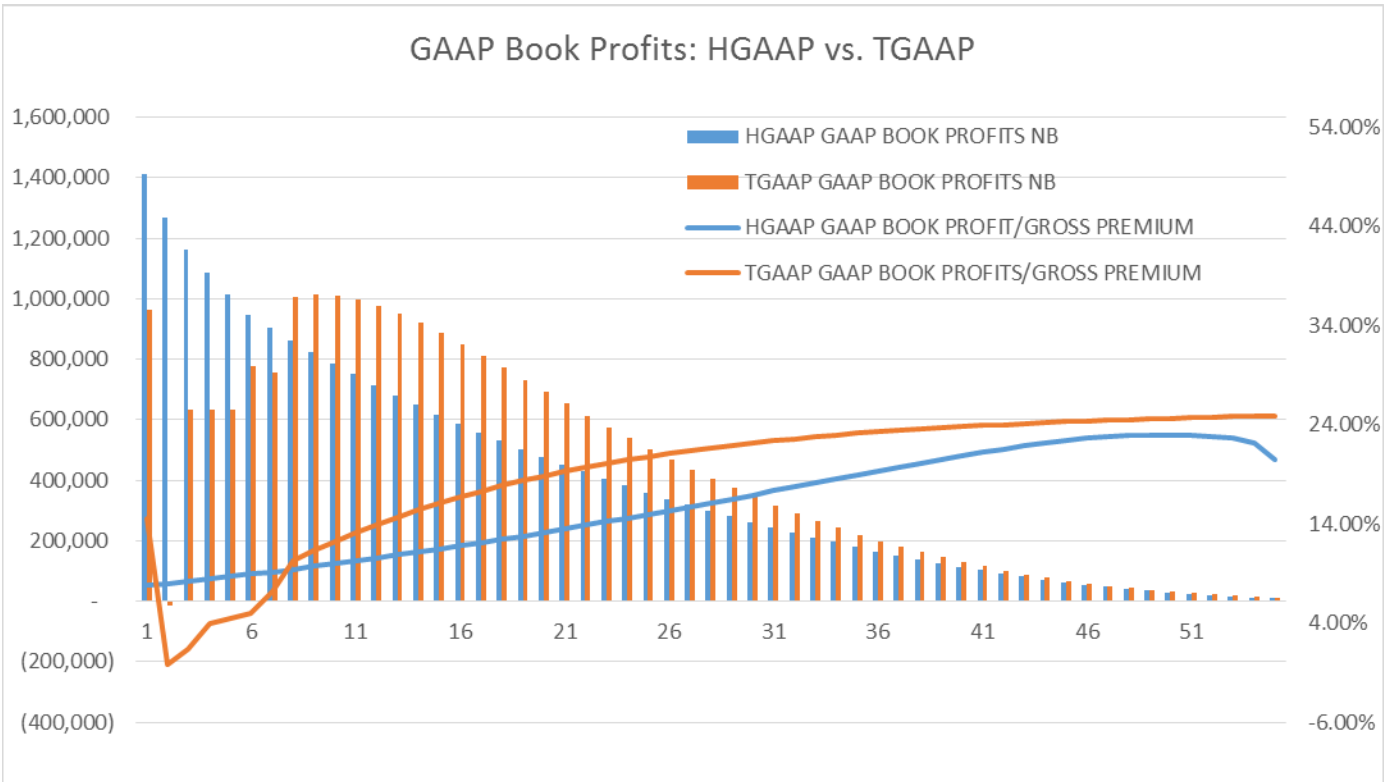


New Business Traditional Life Examples

HGAAP New Business vs TGAAP New Business: No Transition

GAAP Book Profits for HGAAP and TGAAP differ due to the following components:

- GAAP Book Profits ("GBP") excludes interest on surplus. Under HGAAP, the GBP declines with the population and gross premiums. Under TGAAP GBP are pushed to the center of the lifetime with a pattern more like a benefit reserve.



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FASB Targeted Improvements for Long Duration Products

ASC 944 (Previously known as “FASB 60”)

Single Premium immediate Annuity Product: Comparison of a New Issue under HGAAP and TGAAP

Product

- Issue Age: 80
- Gender: Female
- Monthly Benefit: 305/Monthly for Life
- Single Premium: 40,000
- Acquisition Cost: $2,000

HGAAP Assumptions

- Starting Cohort: 1,000 lives
- Investment Yield: 3.54%
- Valuation Rate PAD: -25 bps
- Mortality: 1983 IAM
- Mortality PAD: 0%

TGAAP Assumptions

- *Discount Rate: 2.26%
- No PADs

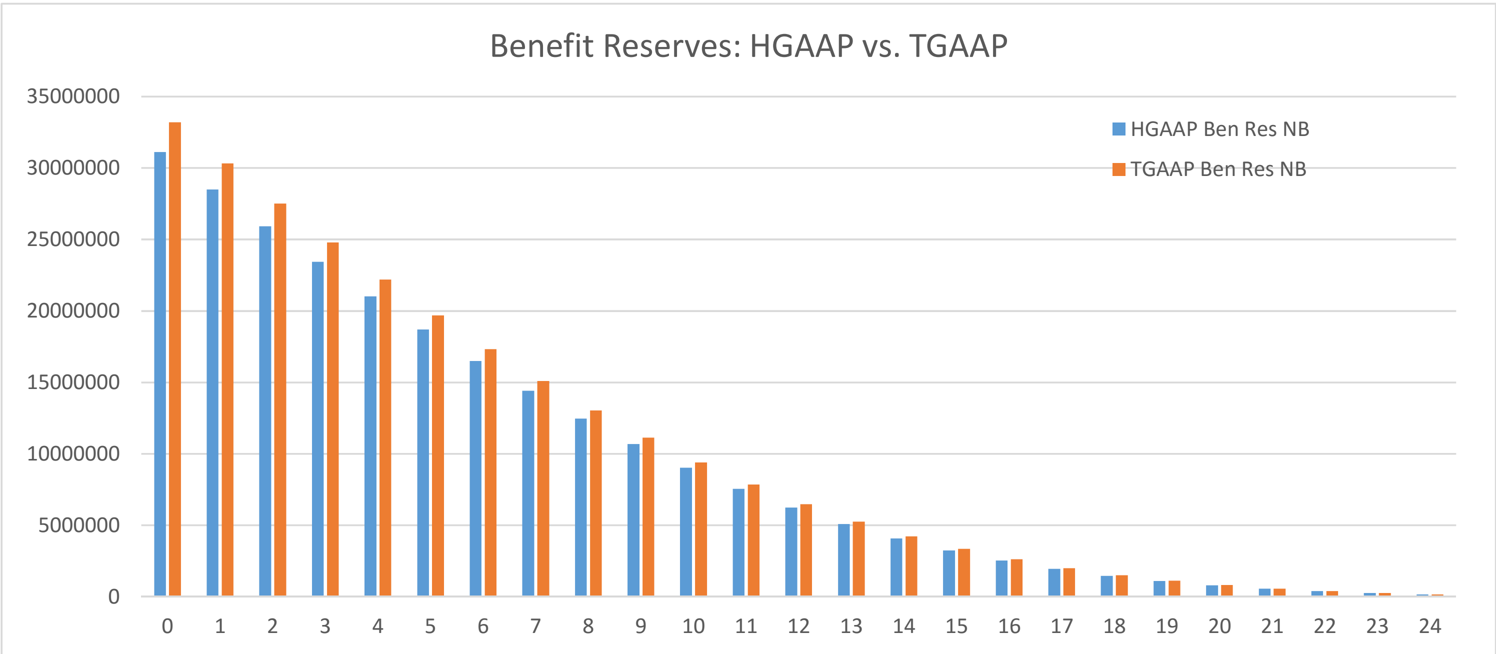
*Note that this example used a high quality investment vehicle. This was not updated for FASB comments dated early October 2017. The results are valid as originally modeled.

New Business SPIA Examples

HGAAP New Business vs TGAAP New Business: No Transition

Benefit Reserves for HGAAP and TGAAP differ due to the following components:

- PADS: HGAAP has -25 bps discount rate PAD.
- Discount Rate: HGAAP uses a portfolio based discount rate less a PAD (3.54% before PAD). TGAAP uses a single equivalent yield determined from the investment vehicle yield curve* (AA, 2.26%) discount rate.



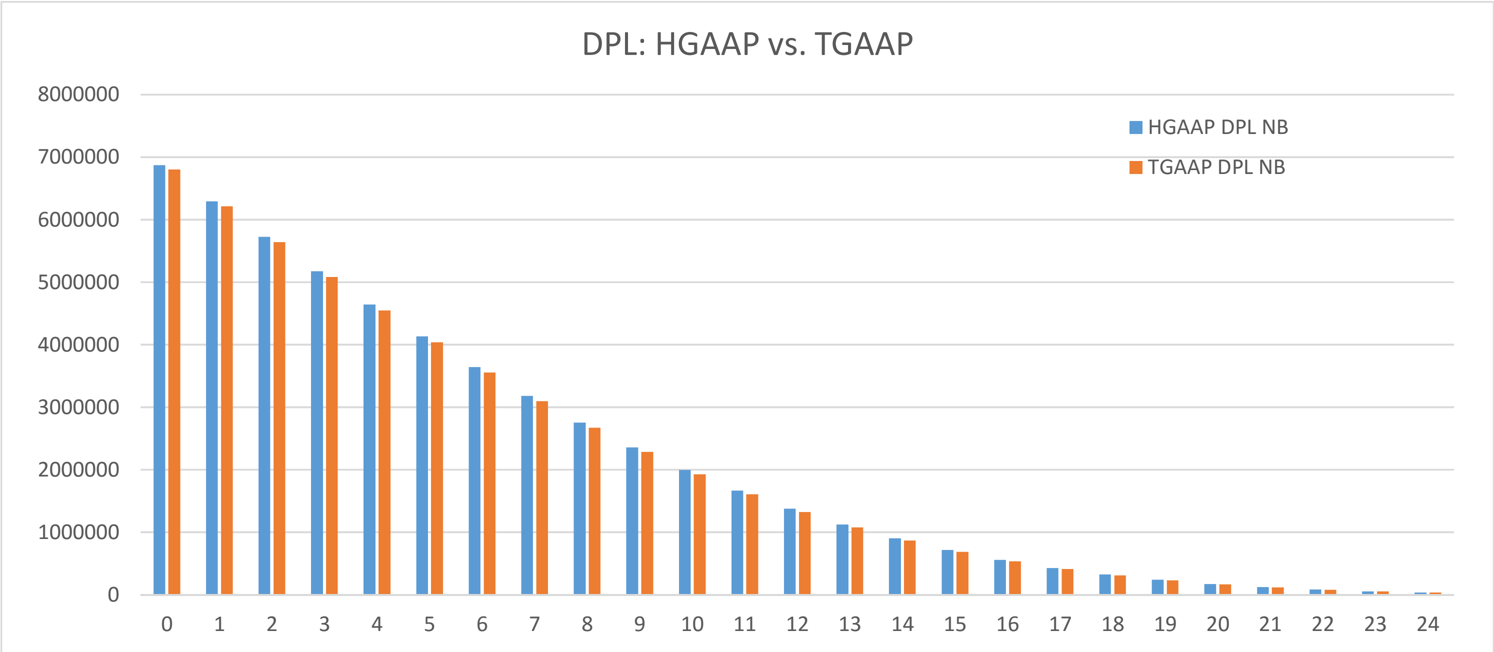
*Note that this example used a high quality investment vehicle. This was not updated for FASB comments dated early October 2017. The results are valid as originally modeled.

New Business SPIA Examples

HGAAP New Business vs TGAAP New Business: No Transition

Deferred Profit Liability for HGAAP and TGAAP differ slightly due to the following components:

- PADS: HGAAP has -25 bps discount rate PAD.
- Discount Rate: HGAAP uses a portfolio based discount rate less a PAD (3.54% before PAD). TGAAP uses a single equivalent yield determined from the investment vehicle yield* curve (AA, 2.26%) discount rate.



*Note that this example used a high quality investment vehicle. This was not updated for FASB comments dated early October 2017. The results are valid as originally modeled.

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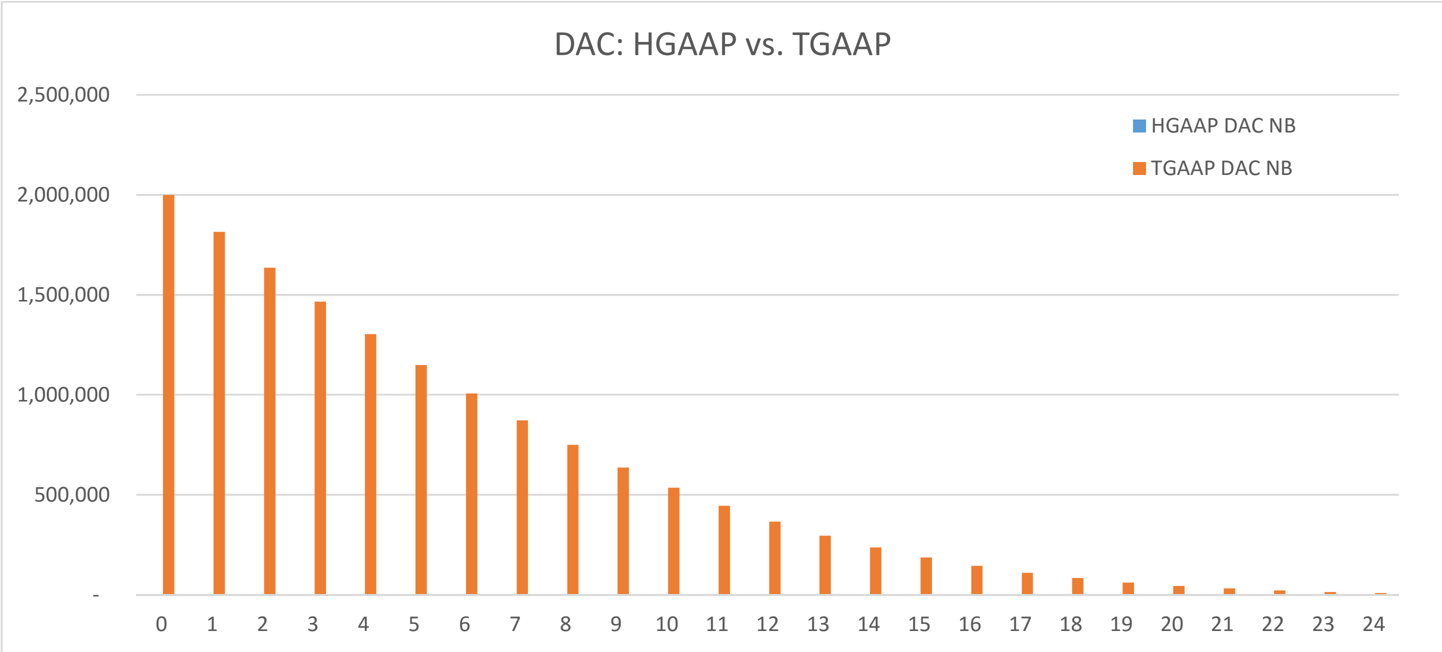
New Business SPIA Examples

HGAAP New Business vs TGAAP New Business: No Transition

DAC for HGAAP and TGAAP differ due to the following components:

- PADS: HGAAP has -25 bps discount rate PAD.
- Basis for Amortization: The HGAAP basis for amortization is the gross premium. TGAAP is the sum of expected benefits. The removal of the matching principle is evident here.
- Method for Amortization: TGAAP uses a run-off method over the sum of expected benefits.

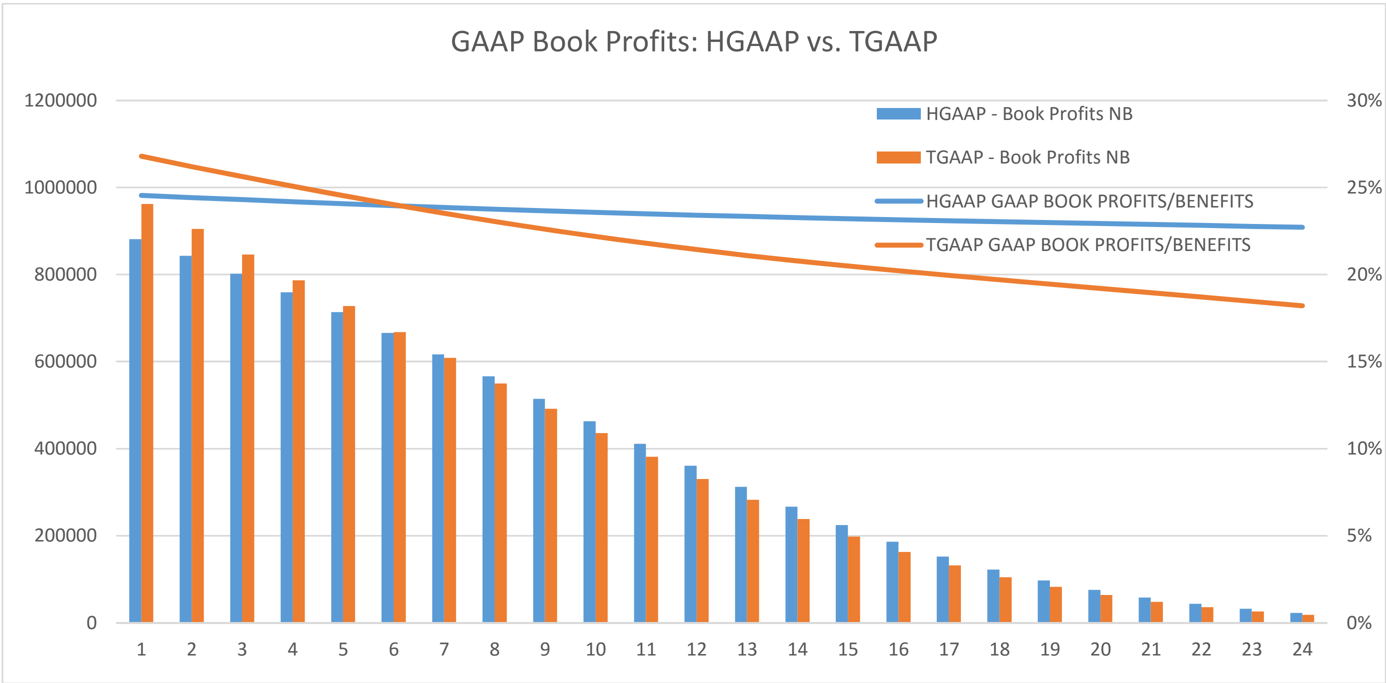


New Business SPIA Examples

HGAAP New Business vs TGAAP New Business: No Transition

GAAP Book Profits for HGAAP and TGAAP differ due to the following components:

- GAAP Book Profits ("GBP") excludes interest on surplus. Under HGAAP, the GBP declines slightly with the population. The Under TGAAP GBP are higher earlier but lower in the future. This is due to the amortization of DAC. The DPL balances are close but the offsetting DAC amortization under TGAAP pulls down the future GBP. The implicit margin is also larger for TGAAP which makes earnings steeper despite the same PV (GBP).



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FASB Targeted Improvements

Operational Considerations

FASB Targeted Improvements for Long Duration Products

FASB 60

Operational Considerations

- Assumptions
  - A significant amount of historical data will need to be collected and analyzed in order to establish a best estimate and reflect historical cash flows
    - Some existing processes may be leveraged (loss recognition testing) to mine historical best estimates
    - IT resources may be needed in order to manage all of the historical data (also, the pivot approach at transition eliminates these strains)
  - Accounting/Actuarial policies will need to be established/modified/created for the assumption setting
    - Aggregation (revise), Reserve Granularity (revise), Shadow Balances (revise), Assumption Setting (revise), Negative AGP Treatment (delete)
  - The "historical cash flow" requirement may need some interpretation in order to implement

FASB Targeted Improvements for Long Duration Products

FASB 60

Operational Considerations

- Discount Rate
  - Discount Rates at issue are locked in
    - Yield curve/single equivalent yield development decision
    - Optimizing market observable data to be addressed for longer duration products
- Actuarial Methods
  - Interpretations and analysis is required to inform and align the Finance Department and develop data requirements (IT and Investments)
- Valuation System Updates/Upgrades
    - Unlocking Assumptions, one locked-in Discount Rate
    - Revised DAC functionality
    - Updated NLP% and multiple Benefit Reserve calculations

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FASB Targeted Improvements for Long Duration Products

FASB 60

Operational Considerations

- Reporting
  - Internal
    - GAAP book profits will grow in a new pattern that will need to be reflected in any planning process
    - DAC and Benefit Reserve roll forward reports and analysis (reserves per 1,000) will require refinements
    - New ledger entries for FAS 60 will be required
    - Support for Internal Audit and/or Model Validation groups
    - Management Source of Earnings Reports
  - External
    - Rating Agencies
    - Disclosures
    - External Auditors

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