



SOCIETY OF ACTUARIES

**Health Valuation Boot Camp
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Session # 12: Update on U.S. GAAP and IFRS

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GAAP and IFRS

Day 2

Topics to Discuss

- US GAAP and insurance liabilities
 - Standard applicability
 - FAS 60 lock in of liabilities
- IFRS

US GAAP and Insurance Liabilities

- Potential sources of guidance
 - FAS 60/FAS 97
 - Health Care Audit Guide
- Applicability
 - FAS 60 has significant scope limitation
- Contrasts
 - FAS 60 defers acquisition costs/Health Care guide does not
 - FAS 60 requires lock in of long duration assumptions, health care guide is silent

FAS 60 Lock-in Issues

- For long duration contracts, FAS 60 requires original assumptions to be retained
 - Exceptions are premium deficiency or substantially changed internal replacement (SOP 05-1)
 - Problem for health carriers where rate increases are allowed under long duration contracts
 - Historical solutions have been to lock in features such as reserves as a percent of premium or prospective unlocking
 - In January 2009, AICPA issued a Technical Practice Aid saying prospective unlocking was not allowed under FAS 60
 - Issues associated include transition and correction

Lock-in Implications

- Lock-in requires initial assumptions to be made regarding
 - Age curve
 - Future trends
 - Future rate increases
 - Lapse and morbidity
- Statutory is not locked in so may drive another GAAP/Statutory difference
- Consider profit streams:
 - Initial assumptions correct
 - Initial assumptions understate trends/rate increases
 - Initial assumptions overstate trends/rate increases

IFRS

- International Financial Reporting Standards
 - Global economy is dictating common financial reporting standards
 - In US, likely to phase in over next 5-7 years
 - Insurance contracts in two phases
 - Phase I—IFRS 4 is essentially business as usual with respect to US GAAP for health insurance contracts (may be other accounting changes)
 - Phase II may have significant changes but much is yet to be decided

IFRS Phase II Process

- Discussion Paper
 - Released May 2007
 - Comments due by November 2007
 - Exposure draft expected December 2009
 - Adopt standard May 2011
 - If on schedule, US companies will adopt Phase II as they adopt IFRS

IFRS Phase II Issues

- Many issues left to be decided
- Liabilities likely to be:
 - Weighted average of future cash flows
 - Discounted for time value of money
 - Include a risk margin
 - For both pre-claim and post-claim liabilities

IFRS Phase II Implications for Health Carriers

- Common accounting guidance
- Weighted average of cash flows
 - Slight change to existing methodology for both pre-claim and post-claim liabilities
- Inclusion of future premiums for pre-claim liabilities and potential profit at issue
 - Eliminates some of the seasonality issues associated with high deductible products
- Discounting of post-claim liabilities
- Risk margin and profit footprint
- Reflection of company specific cash flows
- Revenue recognition

IFRS Phase II Sales Pitch

- AAA task force forming to address anticipated exposure draft
- Health carrier voice is limited in global insurance discussions
- Get involved