SOCIETY OF ACTUARIES®

2019 ANNUAL MEETING & EXHIBIT

October 27-30
Toronto, Canada

Session 123: Help! I Work in a Smaller Company/Department! What do I do Now?

2019 ANNUAL MEETING & EXHIBIT

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SOCIETY OF ACTUARIES®

October 29th, 2019

SOCIETY OF ACTUARIES
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Active participation in the Society of Actuaries is an important aspect of membership. While the positive contributions of professional societies and associations are well-recognized and encouraged, association activities are vulnerable to close antitrust scrutiny. By their very nature, associations bring together industry competitors and other market participants.

The United States antitrust laws aim to protect consumers by preserving the free economy and prohibiting anti-competitive business practices; they promote competition. There are both state and federal antitrust laws, although state antitrust laws closely follow federal law. The Sherman Act, is the primary U.S. antitrust law pertaining to association activities. The Sherman Act prohibits every contract, combination or conspiracy that places an unreasonable restraint on trade. There are, however, some activities that are illegal under all circumstances, such as price fixing, market allocation and collusive bidding.

There is no safe harbor under the antitrust law for professional association activities. Therefore, association meeting participants should refrain from discussing any activity that could potentially be construed as having an anti-competitive effect. Discussions relating to product or service pricing, market allocations, membership restrictions, product standardization or other conditions on trade could arguably be perceived as a restraint on trade and may expose the SOA and its members to antitrust enforcement procedures.

While participating in all SOA in person meetings, webinars, teleconferences or side discussions, you should avoid discussing competitively sensitive information with competitors and follow these guidelines:

- Do not discuss prices for services or products or anything else that might affect prices
- Do not discuss what you or other entities plan to do in a particular geographic or product markets or with particular customers.
- Do not speak on behalf of the SOA or any of its committees unless specifically authorized to do so.
- Do leave a meeting where any anticompetitive pricing or market allocation discussion occurs.
- Do alert SOA staff and/or legal counsel to any concerning discussions
- Do consult with legal counsel before raising any matter or making a statement that may involve competitively sensitive information.

Adherence to these guidelines involves not only avoidance of antitrust violations, but avoidance of behavior which might be so construed. These guidelines only provide an overview of prohibited activities. SOA legal counsel reviews meeting agenda and materials as deemed appropriate and any discussion that departs from the formal agenda should be scrutinized carefully. Antitrust compliance is everyone’s responsibility; however, please seek legal counsel if you have any questions or concerns.

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Section 811(d)

- The TCJA amended section 811(d) to provide that, for the purposes of Part I of Subchapter L (other than section 816):
  - Amounts in the nature of interest to be paid or credited under any contract for any period which is computed at a rate which:
    - 1) exceeds the interest rate in effect under section 808(g) for the contract for such period, and
    - 2) is guaranteed beyond the end of the taxable year on which the reserves are being computed,
  - shall be taken into account in computing the reserves with respect to such contract as if such interest were guaranteed only up to the end of the taxable year.
- Section 808(g) references the prevailing interest rate, which mean the highest assumed interest rate permitted by to be used in computing life insurance reserves in at least 26 states

Section 811(d)

- Prior to amendment by the TCJA, section 811(d)(1) referenced the greater of the prevailing state assumed interest rate or the applicable federal interest rate in effect under section 807
  - This language was in place for nearly 20 years

2019 ANNUAL MEETING & EXHIBIT

Session 123: Help! I Work in a Smaller Company/Department! What do I do Now?

Statutory Issues

Bill Sayre

October 29th, 2019

Statutory Changes - Topics

- PBR Assumption and Model Governance – can it ultimately help our modeling approach
- PBR Credibility – can a simplified approach work
- Regulatory Demands – how to handle the pace of change

PBR Assumption and Model Governance

- PBR Requirements: VM-G
- PBR Requirements: VM-31
- ASOPs

Attribution for this portion to Tim Cardinal, Arnold Dicke and Aaron Bush – see their May 23rd webcast on PBR for Smaller Companies for more detail

VM-G Requirements

VM-G Section Headings

- Section 2 – Guidance for the Board
- Section 3 – Guidance for Senior Management
- Section 4 – Responsibilities of Qualified Actuaries

VM-G: Board Responsibilities

- Material weaknesses in internal PBR controls—oversight of identification and correction processes
- Infrastructure used for the PBR valuation process (policies, procedures, controls, and resources)—oversight
- Senior management reports and certifications related to the PBR valuation—review
- Board reviews and actions related to the PBR valuation function--document in board meeting minutes

VM-G: Senior Management Responsibilities

Implementation and ongoing operation of PBR valuation function

- Provision of adequate infrastructure (policies, procedures, controls and resources)
- Consistency of PBR valuation process with company's other risk assessment processes
- Review of significant and unusual issues and findings
- Adoption and implementation of appropriate internal controls on material risks
- Determination that resources are adequate and processes exist to assure models and assumptions provide intended results

Responsibilities of Qualified Actuary under VM-G

1. The responsibility for overseeing the calculation of principle-based reserves for PBR
2. The responsibility for verifying that the assumptions, methods, models, documented internal standards and controls appropriately reflect the requirements of the VM for the group of policies being valued
3. The responsibility for providing a summary report to the board and to senior management on valuation processes, valuation results, general level of conservatism in reserves, materiality of reserves in relationship to the overall liabilities, and significant and unusual issues and/or findings
4. The responsibility for preparing the PBR Actuarial Report with respect to the PBR policies being valued, as described in VM-31
5. The responsibility for disclosing to the company's external auditors and regulators any significant unresolved issues regarding the company's principle-based reserves

VM-31: Documentation Requirements

- VM-31 as a documentation guide
  - Data requirements—extensive
  - Justification of assumptions and models—evidence-based
  - Governance documentation

VM-31: Possibly Useful Templates

- APF 2019-23
  - Template for giving information about experience studies
- APF 2019-44
  - Templates for giving information on direct and assumed business
- Link: https://www.naic.org/index_committees.htm
  - Click on “Industry” in gray row at top
  - In Principle-Based Reserving box at the right, click on “Valuation Manual (VM) Versions”
  - Then look for “LATF Adopted Amendments for the 2020 VM”

ASOPs possibly affected by enhanced practices

- ASOP # 24—Compliance with Life Insurance Illustrations Model Regulation
- ASOP # 40—Deficiency Reserve Mortality
- ASOP # 52—Principle-Based Reserves for Life Products
- ASOP # 54—Pricing of Life Insurance and Annuity Products

Learnings from emerging best practices for PBR

1. Practices and Resources
2. Model Governance
3. Assumption Governance
4. Documentation

Practices and Resources

VM: new requirements & new demands → new practices and resources

- Discussion and debate
  - YRT, conversions, …
- Academy Practice Notes
  - Model Governance (also Model Governance Checklist)
  - Life PBR Assumptions Resource Manual (Jan 2019)
  - Common Practices of Examining Actuaries Involved in Statutory Financial Solvency Examinations of Life and Health Insurers Exposure Draft (Apr 2019)
  - Principle-Based Approach Projections
- SOA
  - Economic Scenario Generators, Underwriting, Relative Risk Tool, …
- ASOPs
- Regulatory Reviews
  - NAIC Report on 2017 PBR Actuarial Reports (VAWG Report)

Improve Model Foundation

Model Design and Discipline

- Clarify, define and manage staff model responsibilities
- Embed Governance ‘Preferred Practices’ in modeling
  - Model architecture, design and sources
  - Change and access controls
  - Standardize documentation
  - Rigorous validation
  - Scheduled team assumption review
  - Format results for aggregation, reporting, analysis
- General goal is to make modeling look more like financial reporting

Of course, this is not easy

Challenges

- Even this is a significant undertaking
- Nebulous goal – implement model governance best practices?
- Requires resources to make changes

Justification?

- Immediate gains – frequent model runs to support other projects (RBC, GAAP Loss-Recognition, etc)
- Support for other reporting initiatives
- Governance/Discipline 'fronts' expense of model management – initial build takes more effort, but once established maintenance is more manageable and less prone to errors/issues

AAA Model Governance Checklist

AAA Model Governance Checklist (2016)
Governance standards
Modeling Process
Assumption Setting
Input Data/Tables/Mapping
Access Controls
System/Model Changes
Model Selection/Versioning
Result Consolidation
Reporting
Analysis/Validation

Relatively short (20 page) resource document

Includes list of questions – like a ‘self-help’ quiz!

Review then consider what your ideal model structure would look like

https://www.actuary.org/sites/default/files/files/publications/PBRChecklist_Final.pdf

https://www.actuary.org/sites/default/files/files/publications/Model_Governance_PN_042017.pdf

Assumption Governance

- Who Sets Assumptions?
- Process and Control
  - Dealing with disagreement
- Documentation
  - Including justifications

Assumption Governance Committee

Key responsibilities

- Oversight and guidance
- Processes and controls
- Facilitation of discussion, agreement and approval

Learnings from PBR Actuarial Report Submissions

1. VAWG Report
2. Will PBR documentation requirements cross over to non-PBR reporting?

PBR Credibility

Research Project Objectives

- Consider practical implications of mortality credibility on PBR for term insurance
  - Mortality credibility considerations impacting the decision to implement PBR
  - How the impact varies for companies at various levels of credibility
  - Potential impact of reinsurance, including retention limits, on mortality credibility
  - Identification and analysis of sources of external data to enhance credibility

Attribution for this portion to Bryan Amburn, Alijawad Hasham, David Eckrich and Steve Ekblad – see their December 6th 2018 webcast on Practical Analysis of PBR Mortality webcast for more detail

Principle-Based Reserving

Mortality assumption building blocks

Company experience assumption

+

Mortality load linked to ***credibility***

Explicit margin

+

Duration-based grade to industry tables

+

Implicit margin of no future MI

Research project

Baseline model assumptions

Premiums:

- 75th percentile (higher premiums) fully underwritten Term insurance premiums from market source

Mortality:

- Company experience (aggregate): **2015 VBT RR90 for Non-smokers**
  2015 VBT RR100 for Smokers

- Subdivided as follows, while conserving deaths:

Risk Class	Male	Female
N0	135%	125%
N1	115%	105%
N2	95%	85%
N3	85%	75%
S0	120%	115%
S1	80%	75%

Target loss ratio: PV(Death Benefits)/PV(Gross Premiums) of 70%
PV(Death Benefits)/PV(Net Premiums) of 80%

Research project

Baseline model assumptions

Commissions:

Commission	Year 1	Policy Years 2-10	Policy Years 11+
Per Premium	100%	4%	2%

Expenses:

Expense	Acquisition	Maintenance
Per Policy	$200	$55
Per Premium	45.0% + 1.5% Premium tax	1.5% Premium tax
Per Unit	$0.70	$0.00
Inflation	0%	2.0%

VM-20 Margins:

- Lapse: 15%, applied dynamically to ensure conservatism
- Expense: 5%
- Post-level term: 100% shock lapse at the end of the level-term period

Net Asset Earned Rate (NAER):

- 70% A, 30% BBB corporate bonds starting assets, prescribed default costs, reinvestment assumption at 50% AA, 50% A corporate bonds

Research project

Methodology

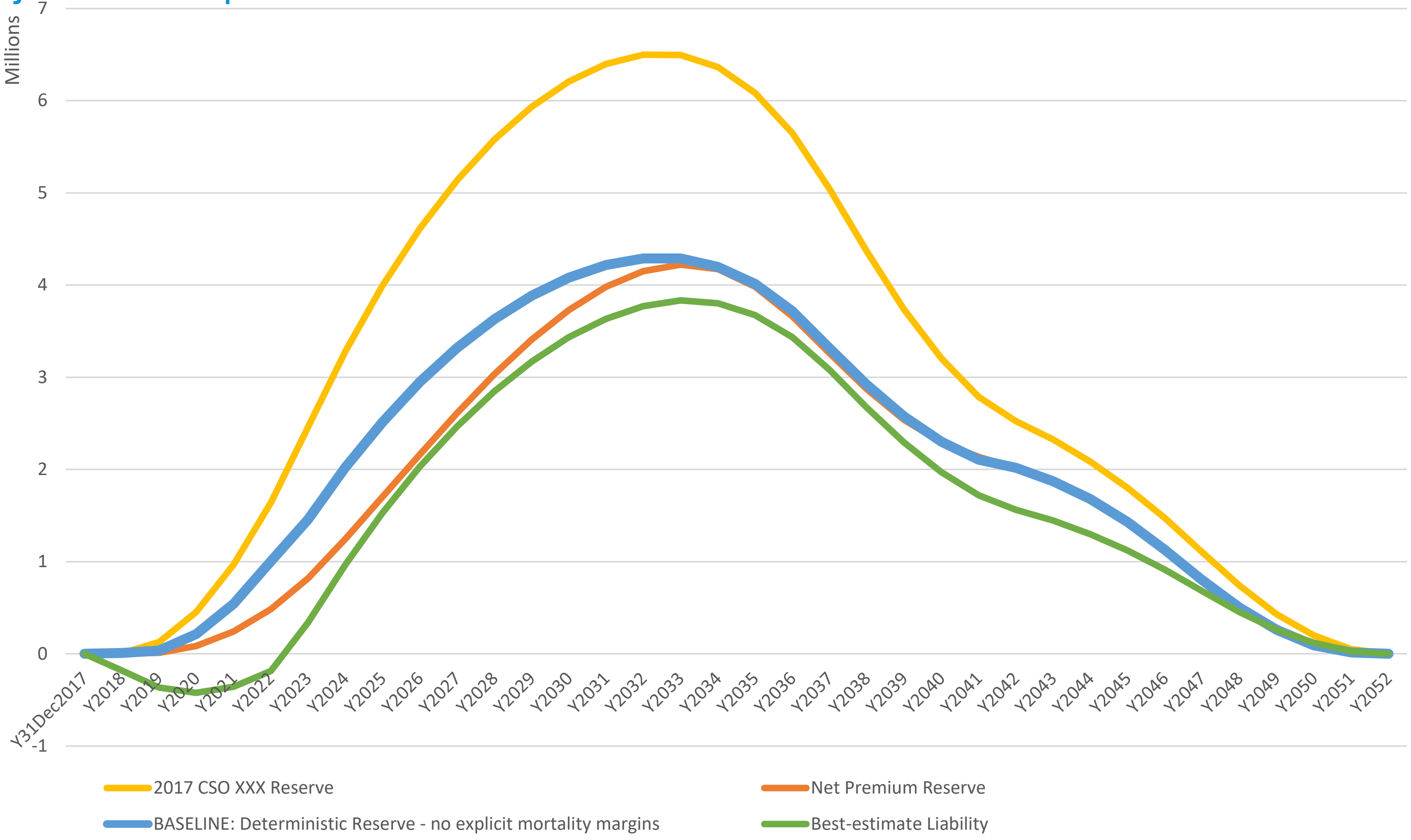
To equate reserve projections, we applied the following techniques

1. Matching reserve peaks
   - Mortality scalar adjustment applied such that the peaks of the reserve projections are equal
   - Colloquially quoted as an impact measure
   - Does not account for the different shape of the reserve curves

2. Match pricing IRRs
   - Mortality scalar adjustment determined such that pricing IRRs under different reserve projections are equal
   - Incorporates both the different level and shape of the reserve curves

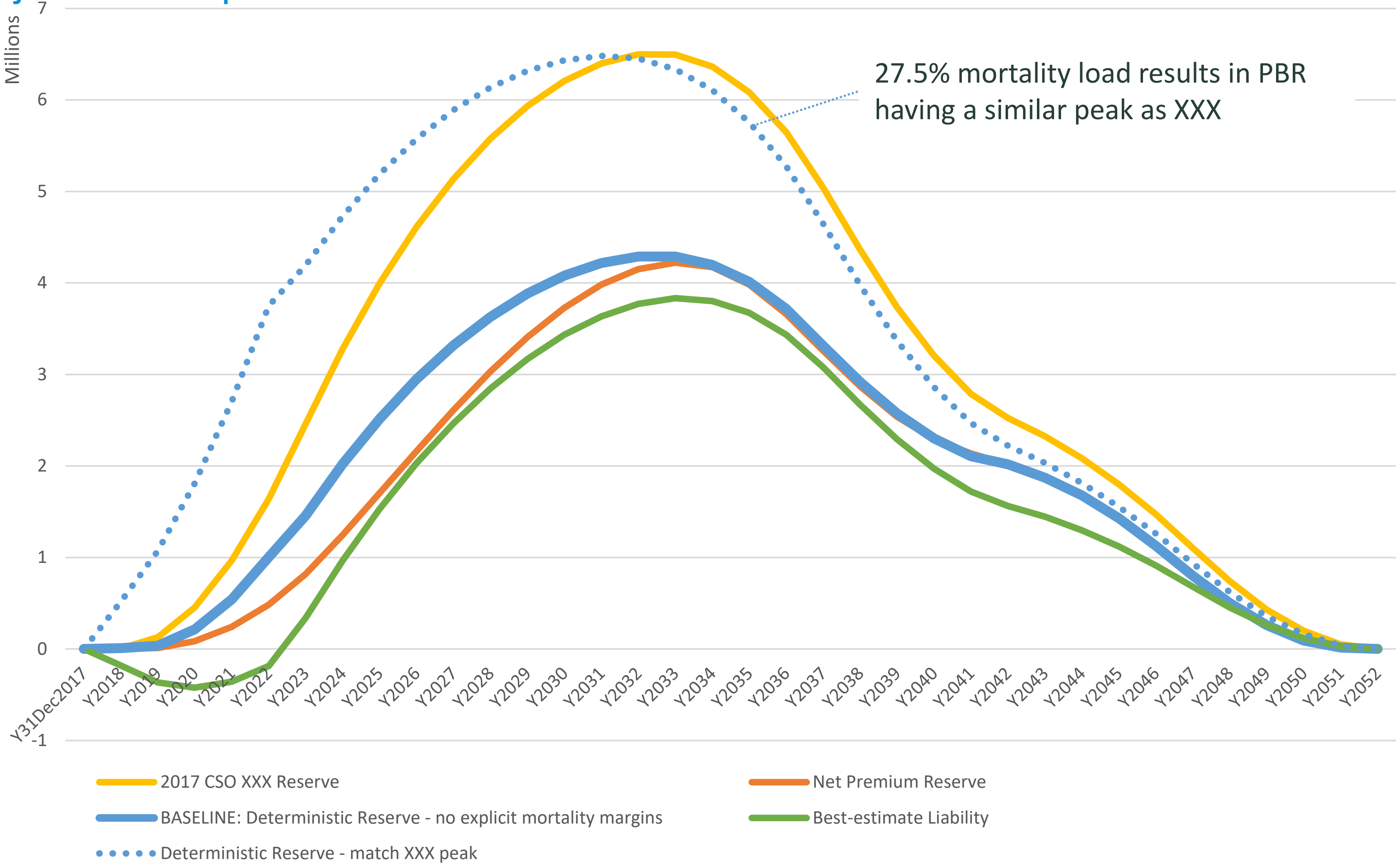
2017 CSO Regulation XXX versus PBR

Reserve projection comparison



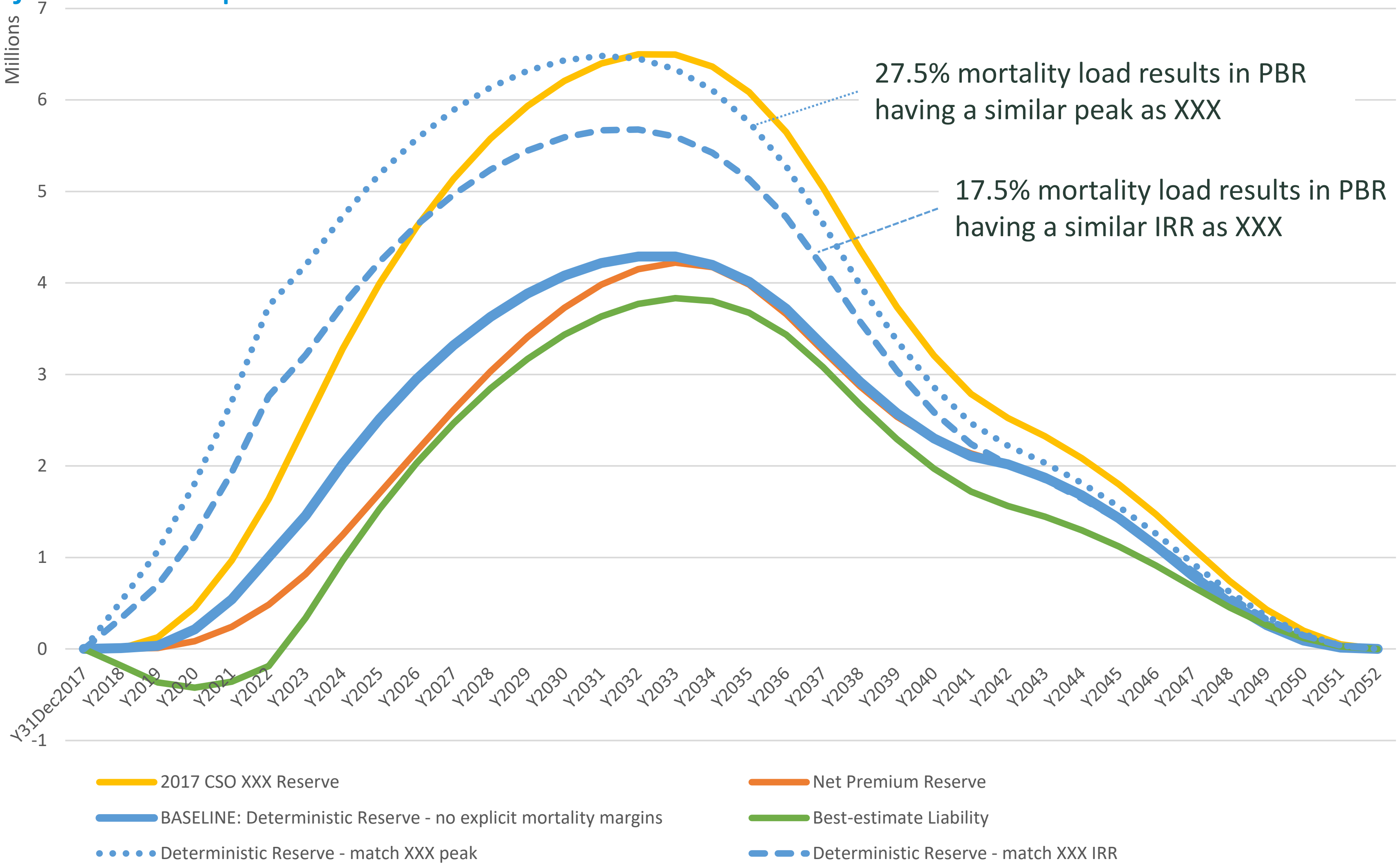
2017 CSO Regulation XXX versus PBR

Reserve projection comparison



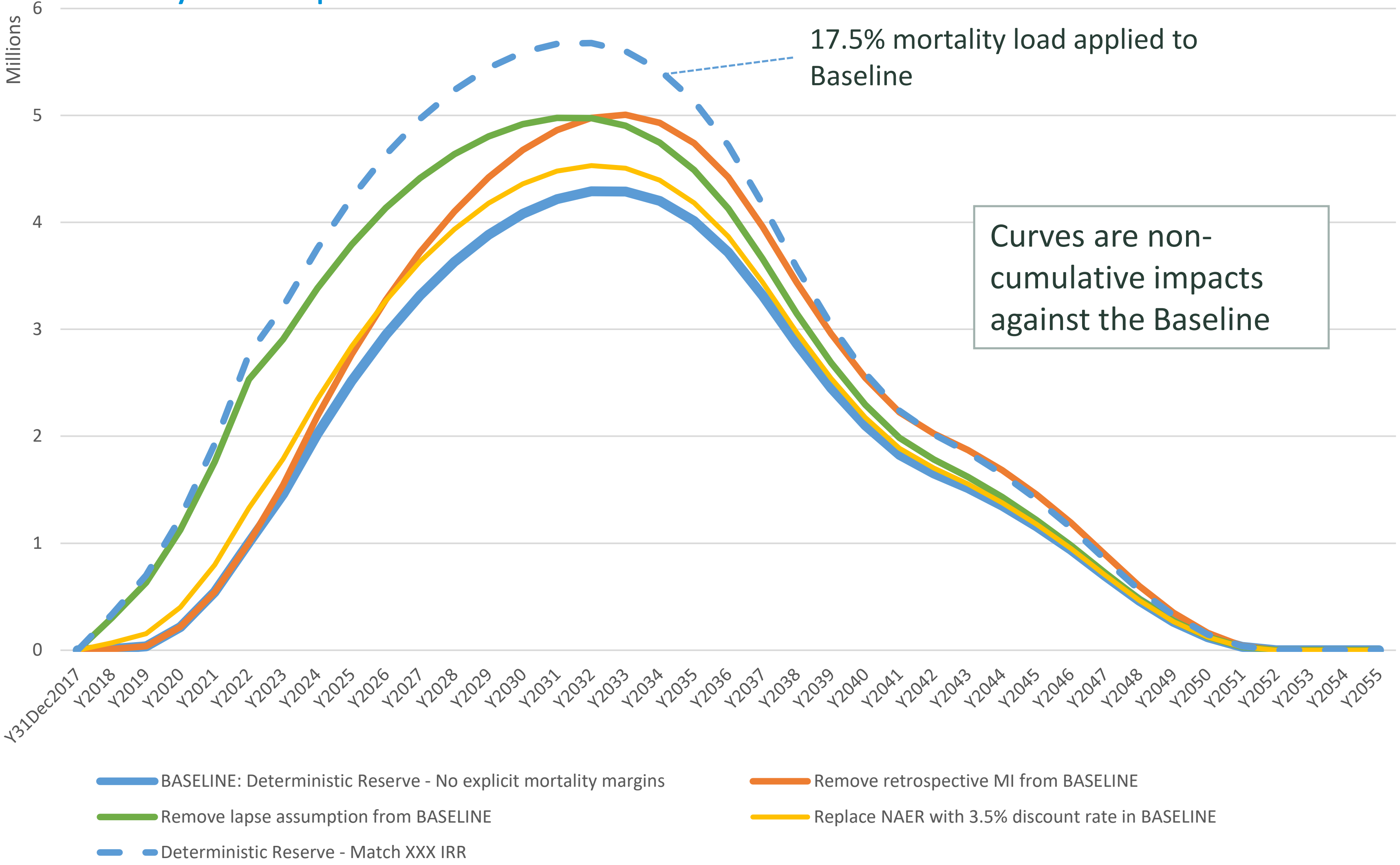
2017 CSO Regulation XXX versus PBR

Reserve projection comparison



2017 CSO Regulation XXX versus PBR

Attribution due to key assumption differences



2017 CSO Regulation XXX versus PBR

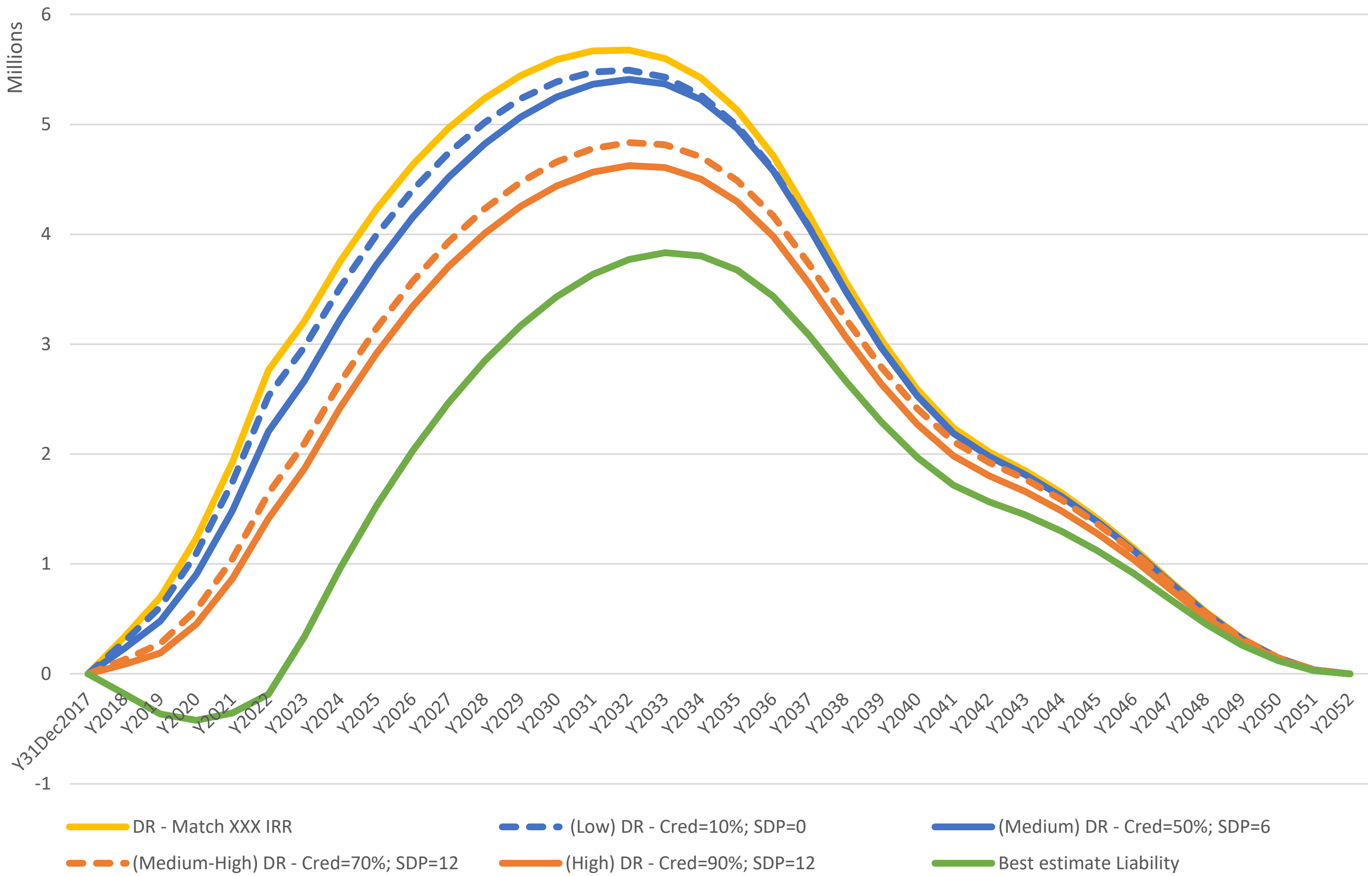
Layering on mortality credibility

A: Limited Fluctuation credibility (%)	B: Sufficient Data Period (years)	C: IRR (%)	D: Mortality scalar to match 2017 CSO XXX IRR (%)	E: Approximate credibility-based mortality margin (%)
2017 CSO XXX reserve		6.2	N/A	N/A
10	0	6.3	2.0	15.5
30	2	6.3	2.0	15.5
50	6	6.5	4.0	13.5
50	12	6.7	7.0	10.5
70	12	7.1	10.0	7.5
90	12	7.6	12.5	5.0
90	16	7.7	13.5	4.0
99+ (Bühlmann)	16	8.0	15.0	2.5
Baseline DR – no explicit margin		8.7	17.5	-

*No recognition of future mortality improvement equates to an ~**7.6%** implicit mortality load

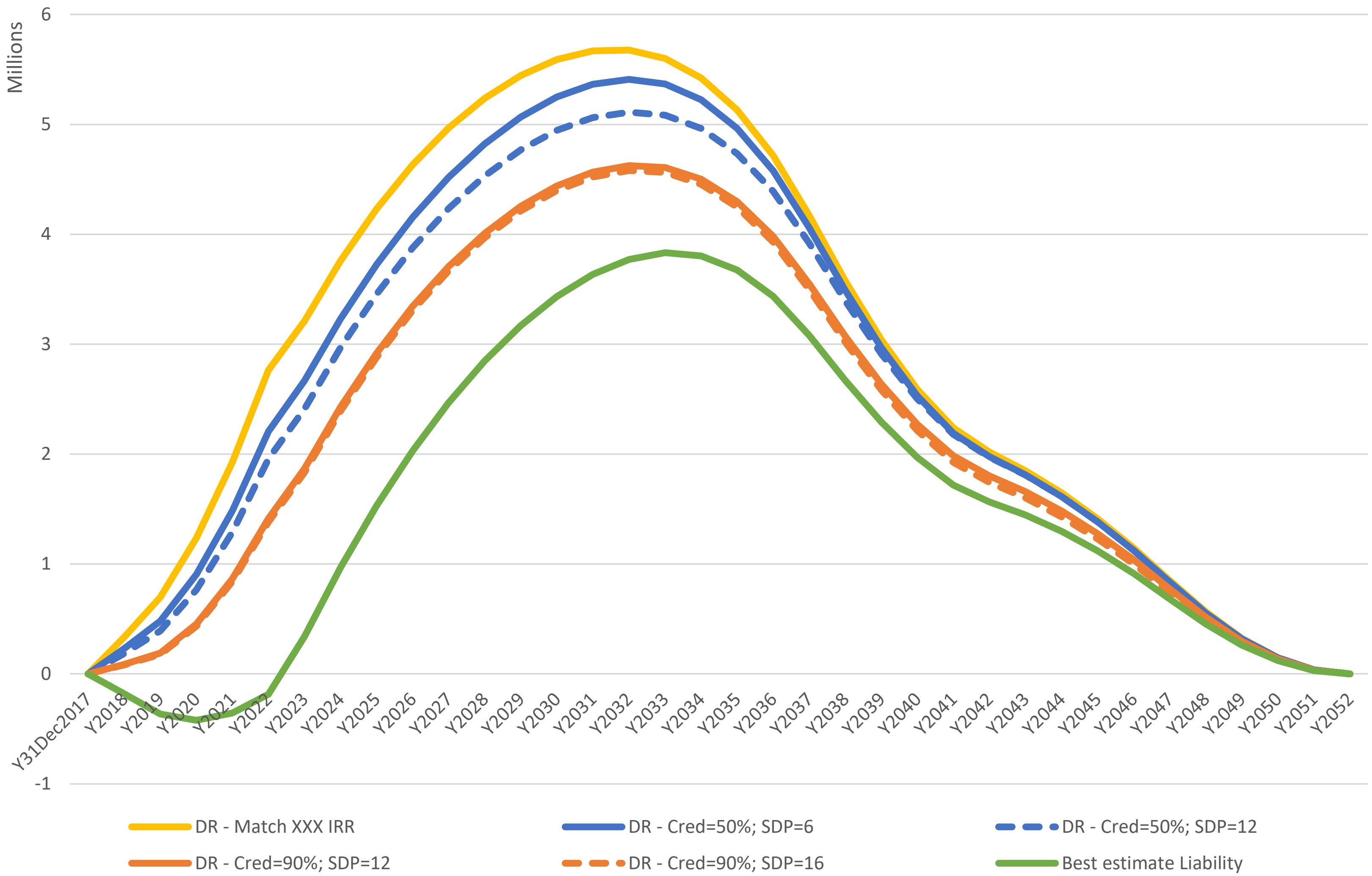
PBR deterministic reserve

Impact of credibility



PBR deterministic reserve

Impact of sufficient data period (SDP)



PBR deterministic reserve

Illustrative credibility and SDP by company profiles

Company Profile	Bühlmann Credibility	Sufficient Data Period	IRR
A: Large established company	98%	20	7.8%
B: Large established company with recent significant change to underwriting/target market/distribution channel	90%	10	6.9%
C: Mid-size established company	85%	14	7.0%
D: Recent entrant with focus/strong growth on Term only business	75%	8	6.6%
E: Small company	30%	2	6.3%
F: FinTech/Start-up insurance company	0%	0	6.3%

*The values above are meant to be representative but do not capture actual companies. In the real world there will be a range of credibility outcomes around the values above.

Mortality assumption setting

Basis for use of external data

VM-20 Section 9.A.6.a

- For risk factors (such as mortality) to which statistical credibility theory may be appropriately applied, the company shall establish anticipated experience assumptions for the risk factor by combining relevant company experience with industry experience data, tables, or other applicable data in a manner that is consistent with credibility theory and accepted actuarial practice.

Mortality assumption setting

Requirements

VM-20 Section 9.C.2

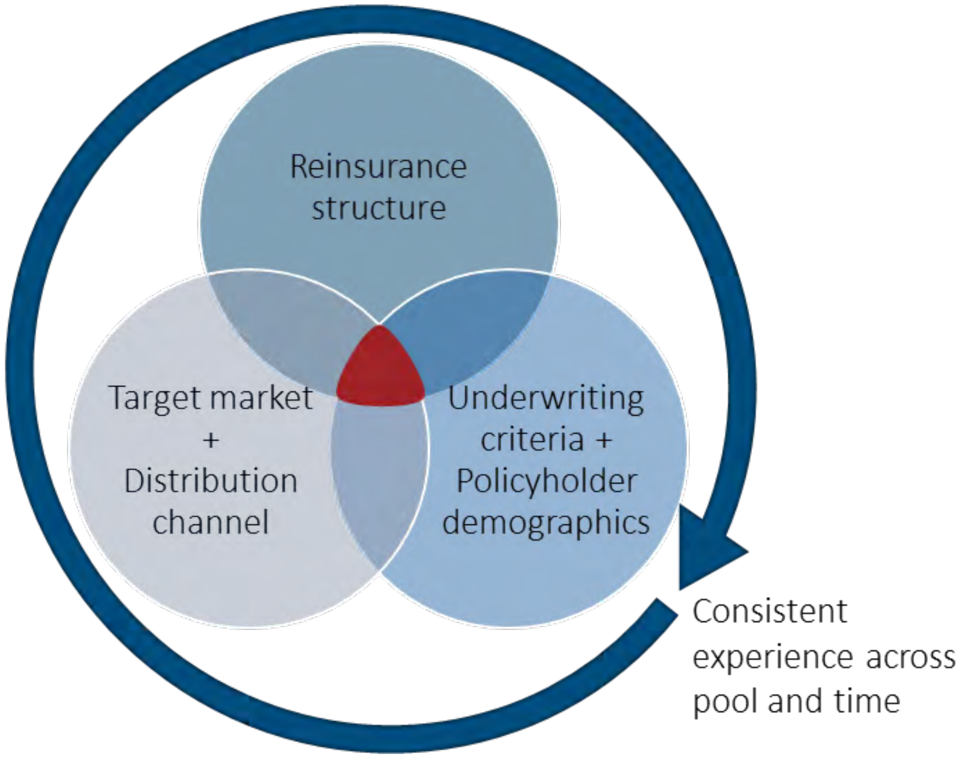
- ❑ Requires companies to derive its experience mortality rates from experience data
- ❑ Experience data shall be based on
  - i. Actual company experience for mortality segment
  - ii. Experience from other books with similar underwriting
  - iii. Experience data from other sources, if available and appropriate
    - Includes actual experience data of one or more mortality pools in which the policies participate under the term of a reinsurance agreement
    - Data from other sources is appropriate if the source has underwriting and expected mortality experience characteristics that are similar to policies in the mortality segment

Mortality assumption setting

Key considerations

1. Relevancy
    - Similar underwriting and expected mortality characteristics
    - Reinsurance experience is a blend that may not be fully representative of ceding company

Relevancy drivers



Mortality assumption setting

Key considerations

2. Confidentiality

- Non-disclosure and/or product development agreements may limit reinsurers' ability
- Other reasons to avoid sharing

Mortality assumption setting

Key considerations

3. Burden of justification

- The relevancy and appropriateness of the reinsurance data needs to be demonstrated
- Who, and how does one justify?
  - VM-31 requirements
  - Reliance statements

Mortality assumption setting

Additional margin

VM-20 Section 9.B.2

- Requires a larger margin where there is greater uncertainty in the anticipated experience assumption
- For example, the company shall use a larger margin when:
    a. Experience data has less relevance or lower credibility
    b. Experience data is of lower quality
        - Example: incomplete, internally inconsistent, or not current
    c. There is doubt about the reliability of the anticipated experience assumption
    d. Modeling constraints limit an effective reflection of the risk factor

Mortality assumption setting

Sources of external data

Data Source	Benefit	Cost
Reinsurer	1. **Relationship:** Data submission channel already exists 2. **Relevancy:** More industry, business and assumption-setting knowledge to better determine relevancy 3. **Ownership of data:** Owns reinsurance data 4. **Long-term stability:** Vested interest in underlying data	1. **Cost (explicit):** Comp either through reinsurance or fees 2. **Cost (implicit):** Ties you to a reinsurer
Data aggregator	1. **Relationship:** Data submission channel may already exist 2. **Relevancy:** Have granularity and credibility expertise, but not necessarily business knowledge	1. **Cost (explicit):** Comp through fees 2. **Relationship:** Need to submit data if relationship does not exist 3. **Ownership of data:** Do not own data without explicit consent for other uses 4. **Long-term stability:** Less skin in the game
Life insurer (sister within group)	1. **Cost (explicit):** Likely none 2. **Relevancy:** Relatively straightforward to assess relevancy	1. **Cost (implicit):** Limited credibility enhancement

References

- 2018 Edition – Valuation Manual
- Life Principle-Based Reserves Under VM-20 Practice Note
- Amendment Proposal Form 2018-17: Aggregation of Mortality Segments Exposure Draft
- ‘A VM-20 Mortality and Credibility Factor Observation’, Article from Small Talk, September 2017, Issue 48

Regulatory Demands

- Only seem to increase from year to year
- Make sure you have a long runway
- Cultivate strong relationships with regulators
- Ask for extensions where necessary and practical
- Know your resources

Attribution for this portion to Larry Seller, Bryan Amburn, and Bill Sayre – see their August 27th 2018 Valuation Actuary Symposium Appointed Actuary Boot Camp session for more detail

Seek Guidance from Published Sources

Actuarial Standards of Practice

- http://www.actuarialstandardsboard.org/asops.asp
- http://www.actuary.org/content/applicability-guidelines-actuarial-standards-practice-0
- ASOP 7 (Performing Cash Flow Testing for Insurers)
- ASOP 22 (Statutory Statements of Opinion Based On Asset Adequacy Analysis)
- ASOP 23 (Data Quality)
- ASOP 25 (Credibility)
- ASOP 28 (Statements of Actuarial Opinion Regarding Health Insurance Liabilities and Assets)
- ASOP 41 (Actuarial Communications)
- ASOP 52 (PBR for Life Products under the NAIC Valn Manual)

Seek Guidance from Published Sources

- Current ASOP Exposure Drafts – None applicable
  - http://www.actuarialstandardsboard.org/drafts/ongoing-exposure-drafts/
- Key recent drafts
  - ASOP 2 – Nonguaranteed Elements – April 2019
  - ASOP 22 – Statements of Actuarial Opinion – March 2019
  - Setting Assumptions – March 2019
  - Modeling – February 2019

Seek Guidance from Published Sources

Review the Actuarial Opinion and Memorandum Regulation as defined by your home state

- Almost all states have approved the 2001 AOMR (as of early 2018)
- VM-30 Effective for 2017 filings in 2018 (for states that have adopted the valuation manual)
- Certain states do not require a Regulatory Asset Adequacy Issues Summary (RAAIS) or only require it for domestic companies

Seek Guidance from Published Sources

Practice Notes

- http://www.actuary.org/category/site-section/public-policy/life/practice-notes
- Statutory Financial Solvency Examinations
- Life Insurance Illustrations
- PBR Assumptions Resource Manual
- Asset adequacy analysis (currently listed as exposure draft)
- Life PBR under VM-20
- Optional Retrospective Application of ASU 2010-26 Acquisition Costs
- Application of C-3 Phase II and AG XLIII
- Scenario and cell model reduction
- NAIC Model Regulation XXX (2001&2006 versions)
- Model Governance Practice Note
- Other topics – fair value, embedded value, credibility theory and guaranteed benefit accounting guidance, C-3 Phase III

Seek Guidance from Published Sources

AAA Life and Health Valuation Law Manual

- http://www.actuary.org/content/life-health-valuation-law-manual
- Requires subscription
- Updated annually; 2019 manual (covering year-end 2018) currently available
  - 2020 covering year-end 2019 will be released around 1/31/20
- Contains:
  - state-by-state valuation law summaries
  - Current and selected past versions of applicable NAIC model laws and regulations, including the Valuation Manual
  - Current versions of applicable New York regulations
  - Current versions of NAIC Actuarial Guidelines
  - Generally distributed interpretations and adoption status of key model laws and regulations
  - Overview of current topics as of the date of the manual

State Specific Requirements

- Several states have issued guidance from time to time to the valuation actuary
- NY Specific
  - https://www.dfs.ny.gov/apps_and_licensing/life_insurers/industry_letters_surveys_more_domestic (this is to domestic)
  - Special Considerations Relating to December 31, 2018 Reserves and Other Solvency Issues
  - Actuarial Opinion Requirements for December 31, 2018 Reserves
  - AOM & Risk Based Capital Checklist
  - 2019 SCL to be released around early November

State Specific Requirements

- NY Specific (continued)
  - Requirements for Using the 2001 CSO Mortality Table
  - Maximum Reserve Valuation and Maximum Life Policy Non-forfeiture Interest Rates
  - Liquidity and Severe Mortality Inquiry
  - Domestic companies have other requirements for EDP filing, as well as various checklists and questionnaires that should be completed
  - A Section 8 Opinion is required for all companies with greater than $100 million admitted assets

State Specific Requirements

- California Specific
  - http://www.insurance.ca.gov
  - 2017 Actuarial Memorandum and Regulatory Asset Adequacy Issues Summary (November 20, 2018)
  - http://www.insurance.ca.gov/0250-insurers/0300-insurers/0100-applications/financial-filing-notices-forms/upload/Actuarial-Memorandum-and-Executive-Summary.docx
  - 2019 Holiday Letter released around early November

State Specific Requirements

- Ohio Specific
  - issues a valuation letter to domestic companies related to the year-end requirements
- Pennsylvania Specific
  - requirements for domestic companies
- Other

2019 ANNUAL MEETING & EXHIBIT

SOCIETY OF ACTUARIES®

Targeted Improvements to the Accounting for Long-Duration Contracts

2019 Annual Meeting and Exhibit

October 29, 2019

Insurance contracts – FASB initiatives

Long-duration contracts

- **Focused efforts on targeted improvements to both accounting and disclosures**
- **Change to current U.S. GAAP model for recognition, measurement, presentation and disclosure**

Agenda

- Timeline
- Overview
- Nonparticipating and limited-payment contracts
- Participating contracts
- Long-duration contracts with market risk benefits
- Deferred acquisition costs (DAC)
- Disclosures

Effective Date

Company type	Effective date for calendar year-end companies
SEC filers that are not smaller reporting companies	January 1, 2022
SEC filers that are smaller reporting companies	January 1, 2024
Public business entities that are not SEC filers	January 1, 2024
All other companies	January 1, 2024

Smaller reporting companies
Registrants with a public float of less than $250 million, as well as registrants with annual revenues of less than $100 million for the previous year and either no public float or a public float of less than $700 million

Overview – Changes to liability for future policy benefits

Best estimate assumptions

— Cash flow assumptions updated at least annually on a catch-up basis*
* Previously referred to as the retrospective approach
— Discount rate assumptions updated each reporting period on an immediate basis

Income statement impact

— Cash flow assumption changes reflected in P&L
— Discount rate assumption changes reflected in OCI
— Market risk benefit changes reflected in P&L, except instrument-specific credit risk is reflected in OCI

ASU Long-Duration Liability

Reserving model

— Retained the net premium reserving model
— Provision for adverse deviation and premium deficiency reserve removed from determination of the liability

Disclosures

— Disaggregated rollforwards
— Information about significant inputs, judgments, assumptions and methods

Nonparticipating and limited-payment contracts – Key changes

Cash flow assumptions

Unlocking of assumptions is meant to provide more relevant estimates of future policy benefit reserves

Key changes:

— Updated at least annually in the same quarter every year, but more frequently if experience warrants

— Unlocked and updated on a catch-up basis (previously the retrospective approach) through net income

— Expense assumptions updated consistently with other cash flow assumptions, but can elect on an entity-wide basis to not update (lock-in)

Reflected in the net premium %

Discount rate

Unlocking of the discount rate better reflects the market environment of the liabilities

Key changes:

— Unlocked and updated at each reporting date on an immediate basis in other comprehensive income

— Determine discount rate using an upper-medium grade, fixed income instrument yield (generally an A rating)

Not reflected in the net premium %

Net premium reserving model

Disc rate unlocked

Reserve_t = PV (Benefits + Expenses) − PV (Net Premium % x Premiums)

All cash flow assumptions* unlocked

Disc rate not unlocked

Net premium % = PV (Benefits + Expenses) ÷ PV (Premiums)

*** Expense assumptions are to be updated consistently with the updated methodology used for other cash flow assumptions unless an entity-wide election is made to not update the expense assumption**

Nonparticipating and limited-payment contracts – Discount rate

Current practice is that the discount rate can vary depending on the type of insurance contract. Discount rates can be currently based on: expected investment yield, policy crediting rate, or dividend interest rate.

— Determine discount rate using an upper-medium grade, fixed income instrument yield (generally an A rating)

— Insurance entities would be required to:

- Use reliable information that reflects duration characteristics of the future policy benefit reserves
- Maximize the use of observable inputs and minimize the use of unobservable inputs
- Use the original discount rate as the interest accretion rate

Impact: Discount rate on assets and liabilities are no longer connected; therefore, the Asset Liability Management reported discount rate could be out of sync with the financial statement discount rate

Traditional and limited-payment contracts – Transition

Transition

- Apply to contracts in force using existing carrying amounts at the transition date, adjusted to remove related amounts in accumulated OCI (modified retrospective basis)
  - Transition date defined as the beginning of the earliest period presented
  - Discount rate assumption used to calculate the liability immediately before transition used to:
    - calculate the ratio of net premiums to gross premiums at transition and
    - interest accretion in future periods
  - Remeasure the liability on the balance sheet using the current upper-medium grade (low-credit risk), fixed-income instrument yield to determine the adjustment to opening AOCI at the transition date
- Net premium ratio capped at 100%
- Option to apply the guidance retrospectively, with a cumulative adjustment to opening retained earnings
  - Required to use same contract issue year level on an entity-wide basis for that issue year and all subsequent issue years
  - Required to use actual historical experience information
- Cumulative catch-up applied to opening balance of retained earnings if net premiums > gross premiums or if retrospective approach elected

Impact: Availability of historical information may limit the use of retrospective application for all issue years

Participating contracts

Under current U.S. GAAP, the future policy benefits liability for participating insurance contracts is measured using a separate accounting model that is different from the model used for nonparticipating insurance contracts.

- No change to measurement of the future policy benefit liability for participating contracts
- Simplified DAC amortization model applies to participating contracts
- Accrued terminal dividends accrued are recognized as expense at a constant rate based on the present value of the base used for the amortization of DAC

Impact: The simplified DAC amortization model will still be used for participating insurance contracts

Long duration contracts with market risk benefits

Approach

- One measurement model for all types of contracts with market risk benefits
- Measured at fair value and presented separately on the statement of financial position
- Recognize the change in fair value:
  - in other comprehensive income (OCI) when attributable to a change in the instrument-specific credit risk
  - remainder as a separate line item in the statement of operations

Market risk benefits

A contract feature that:

1) Provides protection to the contract holder from capital market risk; and
2) Exposes the insurance entity to other-than-nominal capital market risk

Impacts: 1. Contract features that were previously embedded derivatives may now be market risk benefits
2. Increased volatility in the P&L due to changes in FV

Long duration contracts with market risk benefits (continued)

Transition

- Retrospective application to all prior periods
  - Maximize the use of relevant observable information as of contract inception
  - Hindsight may be used for assumptions that are unobservable or unavailable
- Difference between fair value and carrying value at the transition date, excluding changes in instrument-specific credit risk, recognized in opening retained earnings
- Cumulative effect of changes in instrument-specific credit risk recognized in accumulated OCI

Deferred Acquisition Costs (DAC)

Under current U.S. GAAP, DAC is amortized in proportion to premiums, gross profits or gross margins

DAC amortization method replaced with a principle in which:

- DAC amortized on a constant level basis over the expected term of the contract(s)
  - Individual contracts: Amortized on a straight-line basis
  - Grouped contracts: Amortized on a constant-level basis that approximates straight-line amortization on an individual contract basis
- Profitability of the contract would not be considered
- Contracts should be grouped consistent with the grouping used to estimate the reserve
- DAC written off when actual experience exceeds expected experience

Concepts eliminated under the proposed standard:

- Accruing interest on the unamortized balance of DAC
- Adjusting DAC for the effect of investment performance or changes in expected future liability cash flows (shadow adjustments)
- Impairment analysis on DAC

Impact: Simplifies the amortization of DAC

Deferred Acquisition Costs (DAC) (continued)

Transition

— Apply to existing carrying amounts at the transition date, adjusted to remove related amounts in accumulated OCI (prospective basis)

— Option to apply the guidance retrospectively, with a cumulative adjustment to opening retained earnings

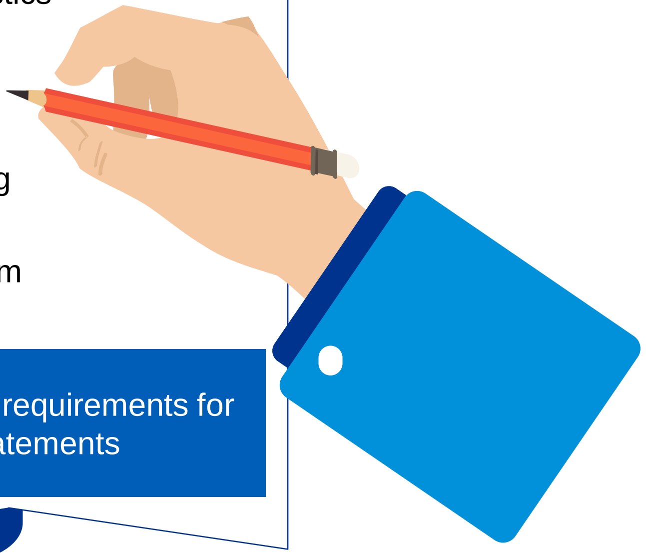
— Required to elect DAC transition method and issue-year level consistent with the liability for future policy benefits

Impact: Availability of historical information may limit the use of retrospective application for all issue years

Disclosures

Additional disaggregated disclosures for the future policy benefit reserves and DAC would include rollforwards of opening and closing balances and quantitative and qualitative information about significant inputs, judgments and assumptions used in the measurement of the liabilities for future policy benefits and DAC.

- Provides a principle for determining how to disaggregate the new disclosures to provide meaningful information without requiring a large amount of insignificant detail or aggregation of items with significantly different characteristics
- Provides examples of disaggregation characteristics (e.g. type of coverage, etc.)
- Consider how information about future policy benefit reserves or DAC has been disaggregated for other purposes when determining which categories would be the most relevant and useful
- Clarifies that the aggregation of the disclosures would at a minimum be consistent with segment-related disclosures



Impact: The proposed ASU would significantly expand the disclosure requirements for long- duration contracts in the annual and interim financial statements