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Major Activity at FASB

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The Financial Accounting Standards Board (FASB) has continued working on its targeted improvements to US GAAP accounting for insurance contracts. During the 4th quarter of 2014 and the 1st quarter of 2015 it made some key tentative decisions on measurement of long-duration insurance contracts, and effectively concluded its project on disclosures for short-duration contracts.

SHORT-DURATION CONTRACTS

Decisions on short-duration contracts probably impact P&C actuaries more than life actuaries. But some life lines of business, such as group or credit insurance, may be impacted by the short-duration contracts project. FASB previously decided not to change the measurement model for short-duration contracts, but determined that some additional disclosures were needed. In March, it apparently finalized the package of additional required disclosures, including:

1. Claims development tables up to 10 years: These are similar to the claim loss triangles in Schedule P of the P&C statutory statements and Schedule O of the Life statements. The tables could cover a period shorter than 10 years if the uncertainty over the claims is resolved over a shorter period.

2. Information about claim frequency: The precise nature of the information will be up to the reporting entity.

3. Development of IBNR and reported claim liabilities.

4. Information about the effect of discounting on claim liabilities: This includes the amount by which the liability is reduced due to discounting, the amount of interest expense recognized in the current period, and the income statement line item within which the interest accretion is recognized.

5. Information about the history of claims duration: This is not required for health insurance.

6. Information about material changes in judgment in the calculation of claims liabilities: This includes the reasons for and the impact of the change.

These new disclosure requirements are due to take effect at year-end 2016 for public companies, and a year later for all other companies.

LONG-DURATION CONTRACTS

Decisions to date:

FASB has previously decided to make targeted improvements to the measurement of long-duration insurance contracts. It began the process in August 2014 with tentative decisions about assumptions for FAS 60 and FAS 97 limited pay reserves (and possibly FAS 120 reserves). It decided to no longer lock-in assumptions, but rather to update assumptions annually in the 4th quarter. It also decided that since assumptions were being updated, there was no longer a need for provisions for adverse deviation (PADs) or for loss recognition/premium deficiency testing on these contracts.

In November, FASB made tentative decisions about the discount rate to be used when calculating reserves for FAS 60 and FAS 97 limited pay contracts, as well as some other liabilities, such as FAS 120 terminal dividend liabilities. It decided that these should use a current discount rate, rather than the locked-in discount rate used today. It also decided that the current discount rate should be a rate based on a portfolio of high-quality, fixed-income investments. This is similar language to that used in GAAP valuation of pension liabilities, and may not necessarily represent the actual portfolio of assets backing the liabilities.

In February, FASB made some tentative decisions about DAC amortization for all long-duration insurance contracts. It decided to no longer amortize DAC in proportion to premiums or EGPs or EGMs. Rather, DAC would be amortized in proportion to the amount of expected insurance in force over the expected life of the contract. If the amount in force cannot be reliably determined or predicted (such as with variable annuities), straight line amortization over the life of the contract would be used. There would no longer be interest accretion on DAC.

The new DAC amortization approach would also apply to other asset and liability balances that are currently amortized like DAC, such as unearned revenue liabilities and deferred sales inducement assets. However, the effective yield method would continue to be used to amortize DAC for investment contracts that use that method today.

Next steps:

None of these changes will take effect for a few more years, and some may be revised in the interim. We expect that FASB will address a few more issues before issuing an exposure draft of the proposed accounting changes. As of March 2015, some of the issues that are likely to be addressed in the future include accounting for variable annuity guarantees and disclosures. In addition, some constituents have raised questions about some of the tentative decisions made to date, and these may also be addressed prior to an exposure draft. These questions include:

- When updating FAS 60 reserve assumptions, would the net premium to gross premium ratio be updated as well? Doing so would mitigate financial statement volatility, but raises other questions, such as whether the update would be retrospective or prospective and whether the ratio would be subject to a cap.
- Would the current discount rate be updated every quarter, or only in the 4th quarter as with assumption changes?
- When amortizing DAC, would the expected life of the contracts be updated? If so, would the update be prospective or retrospective?
- With different valuation bases for DAC and reserves, does the elimination of loss recognition testing need to be revisited?
- Does the requirement to update reserve assumptions apply to FAS 120 reserves, and if so does that imply a need to project expected dividends as well as expenses and lapses?

So clearly there is some work to do before FASB can issue an exposure draft, let alone a final standard revising long-duration insurance contract accounting. But FASB has been moving more quickly and more extensively on this project than some constituents were expecting, so we need to keep paying attention. ■