The Rainbow

By Henry Siegel

I was originally going to title this article "No-See-Ums (3)" since most of what the International Accounting Standards Board (IASB or the board) did this quarter was to again fix problems that had been found with the draft standard. In March, however, I went to St. Thomas for a couple of days and while it rained most of the time, one morning we woke up to the most beautiful rainbows including a double (see photo). I decided this might be an omen that the worst part of the standard development is over and it's now time for the improved accounting resulting from nearly two decades of development to finally be realized.

During the past several months, the board had worked with a number of parties on a field test of the proposed standard. During the course of this test, 29 issues arose that the staff catalogued along with proposed changes to address them. Two of those issues had been extensively debated previously and were therefore discussed separately at the February board meeting.

CHANGES TO THE CONTRACTUAL SERVICE MARGIN

One issue that has been around ever since the board initially decided to allow changes to assumptions about future cash flows is how to treat those changes in the income statement. The board recognized that there are two types of changes to future cash flows: those arising from experience differing from expected (e.g., there are more or fewer policies in force at the end of the reporting period) and those due to changes in assumptions about future experience. The most recent tentative decision had been that the combined effect of the experience and assumption changes should be reflected in earnings. Upon study, however, the staff and board concluded that this approach did not achieve their objectives.

As a result, the board made similar but slightly different decisions for the general model and for contracts measured using the variable fee approach.

For contracts measured under the general model, all changes in estimates of the present value of future cash flows arising from non-financial risks should now be netted against the contrac-

tual service margin (CSM), i.e., either increasing or decreasing it. Unless the CSM goes to zero, or there is a previous loss that is being reversed, this means that there is no effect in current earnings and the effect of the changes is realized in future results. The exception to this rule is that changes due to changes in incurred claims should go to earnings.

The effect of changes to current year cash flows, except for financial risks, still flows through earnings.

For contracts measured under the variable fee approach the decision is consistent, differing only with respect to the effect arising from the underlying items. All changes in estimates of the present value of future cash flows that are unrelated to the underlying items and that arise from non-financial risks are adjusted against the CSM similar to the general model.

The board also agreed to revise the definition of an experience adjustment to exclude investment components. This change makes current year cash flow effects on investment components go to the CSM while all others, as described above, go to P&L.

Operationally, these decisions will create additional work. It would seem, however, that at least most of the information needed should be easily at hand from the models used in the valuation. Probably the most difficult part of the process will be agreeing with your auditor exactly which effects go where.

NARROW EXEMPTION FOR THE GROUPING OF REGULATORY-AFFECTED PRICING OF INSURANCE CONTRACTS

Another issue that arose in the past several years is the requirement to measure in separate portfolios products that were required by regulation (or law) to be priced together. The most common example of such a situation is the pricing of annuities on a unisex basis. The board had been insistent that losses on such products (e.g., on women) should be recognized immediately while profits (on men) should be recognized over time.

At the meeting, however, the board relented to arguments from preparers and users and will allow such products to be measured together so that the combined profit will be recognized over time.

OTHER ISSUES

Staff prepared brief notes on the 27 other sweep issues that had arisen during the review. The board approved the staff's proposals on these as stated in the paper for the meeting. There were another nine issues that staff and board agreed did not need to be addressed.

MARCH PROGRESS REPORT

At the March board meeting, staff reported orally that everything was going as expected and that a final standard was expected at the end of May. Staff also stated that they would be looking for nominees to a transition group around the time the standard is released.

I hope that the transition group will include more than the one or two actuaries that have been included on advisory groups in the past. By now, everyone should realize the key role that actuaries play in insurance accounting and that

Insurance accounting is too important to be left just to the accountants. ■

Henry W. Siegel, FSA, MAAA, is a semi-retired actuary most recently with New York Life Insurance Company. He can be reached at *henryactuary@gmail.com*.