Breakout Session 1:
Focus on FASB Targeted Improvements

Presenters

Thomas Q Chamberlain ASA, MAAA
Deloitte Consulting

Kenneth E. Joyce, FSA, MAAA
Milliman, Inc.
# FASB Targeted Improvements - Contents

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FASB Targeted Improvements
Long Duration Contracts
Summary Update
FASB Insurance Contracts Project History

- **2007**: Issued IASB Issues Paper for comment
  - Decided to join IASB Project

- **2013**: Issued IASB Exposure Draft for comment
  - Decided to leave IASB Project

- **2015**: Completed project on Short Duration Contracts

- **2016**: 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 not 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

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>Proposed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash flow assumptions</td>
<td>Locked-In</td>
<td>Unlocked with changes in P&amp;L</td>
</tr>
<tr>
<td>Discount rates</td>
<td>Locked-In</td>
<td>Unlocked with changes in OCI</td>
</tr>
<tr>
<td>Reserve method</td>
<td>Net Level</td>
<td>Net Level with NPR capped at 100%</td>
</tr>
<tr>
<td>Provision for adverse</td>
<td>Required</td>
<td>None</td>
</tr>
<tr>
<td>deviation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss recognition testing</td>
<td>Required</td>
<td>None</td>
</tr>
</tbody>
</table>

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

- 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

- **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**

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

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

2017
Re-deliberations

2018
Final ASU

2020-2021
Implementation
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

<table>
<thead>
<tr>
<th>Product</th>
<th>Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Issue Age: 45</td>
<td>• Starting Cohort: 1,000 lives</td>
</tr>
<tr>
<td>• Gender: Male</td>
<td>• Investment Yield: 3.54%</td>
</tr>
<tr>
<td>• Face Amount: 1,000,000</td>
<td>• Valuation Rate PAD: -25 bps</td>
</tr>
<tr>
<td>• Annual Gross Premium: 18,000</td>
<td>• Lapse Rates: 12%, 11%, 9,9,9,7,7,7…</td>
</tr>
<tr>
<td>• Acquisition Cost: 100/ policy</td>
<td>• Mortality: 2001 CSO</td>
</tr>
<tr>
<td>• Commission Structure: 80%, 30%, 10%, 10, 10, 10, 5%, 5, 5….</td>
<td>• Mortality PAD: 10%</td>
</tr>
<tr>
<td>• Premium Tax: 11.50%</td>
<td><strong>TGAAP Assumptions</strong></td>
</tr>
<tr>
<td>• Maintenance Expense: $35/policy</td>
<td>• *Discount Rate: 3.50%</td>
</tr>
<tr>
<td></td>
<td>• No PADs</td>
</tr>
</tbody>
</table>

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%
- *Discount Rate: 3.50%
- No PADs
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.

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*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.
## 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

<table>
<thead>
<tr>
<th>Product</th>
<th>HGAAP Assumptions</th>
<th>TGAAP Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Issue Age: 80</td>
<td>• Starting Cohort: 1,000 lives</td>
<td>• *Discount Rate: 2.26%</td>
</tr>
<tr>
<td>• Gender: Female</td>
<td>• Investment Yield: 3.54%</td>
<td>• No PADs</td>
</tr>
<tr>
<td>• Monthly Benefit: 305/Monthly for Life</td>
<td>• Valuation Rate PAD: -25 bps</td>
<td></td>
</tr>
<tr>
<td>• Single Premium: 40,000</td>
<td>• Mortality: 1983 IAM</td>
<td></td>
</tr>
<tr>
<td>• Acquisition Cost: $2,000</td>
<td>• Mortality PAD: 0%</td>
<td></td>
</tr>
</tbody>
</table>

*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.

*DPL: HGAAP vs. TGAAP

*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

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

- **PADS:** HGAAP has a -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).
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
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
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