FINANCIAL ACCOUNTING STANDARDS BOARD

Memorandum

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Contact(s)	**Meredith Brown**	mabrown@fasb.org	(203) 956-3471
	Jeremie Richer	jricher@fasb.org	(203) 956-3468
	Jay Shah	jshah@fasb.org	(203) 956-5340
	Jeff Pooley	jwpooley@fasb.org	(203) 956-3445

Project	**Insurance Contracts**
Topic	**User Outreach Feedback Summary**

Purpose

1. On June 27, 2013, the FASB issued proposed Accounting Standards Update, *Insurance Contracts (Topic 834)*, inviting individuals and organizations to comment on all matters in that proposed Update. Since that date, the Board and the FASB staff performed outreach with many U.S. and global buy-side and sell-side analysts in the life insurance and property and casualty insurance industries. Meetings were conducted both in person and by teleconference, and each meeting included two or more Board members.

2. The FASB staff previously gathered input from the user community on the 2010 Discussion Paper, *Preliminary Views on Insurance Contracts*. A summary of that feedback can be found on the FASB website here.

3. This memorandum summarizes the feedback received during individual user outreach meetings. It is not inclusive of all user feedback received (for example, through comment letters, public round tables or other group forums) and is meant to be read together with the Comment Letter and Other Feedback Summary (Memo No. 109). Overall, the feedback received during individual user outreach meetings is mainly consistent with the other user feedback received through comment letters, public roundtables, and other group forums.

Overview

4. The feedback received on the guidance in the 2013 proposed Update is largely consistent with the feedback received on the 2010 Discussion Paper. The majority of users were concerned that the guidance in the proposed Update would create volatility in reporting entities' financial statements, reduce financial statement comparability, and create a financial statement presentation that is difficult to understand. Some users noted that the proposed Update should provide additional examples to address the complexity of the proposed guidance and to help determine how financial analysis would be impacted.

5. In general, most users supported certain aspects of the guidance in the proposed Update, including the proposed disclosures and the requirement to update assumptions for long duration contracts. Those users agree that these requirements would be an improvement over the requirements in existing U.S. GAAP. However, when discussing the requirement to update assumptions each reporting period under the building block approach, users had a range of opinions on how often assumptions should be updated. Most users stated that, while updating assumptions is an improvement over existing U.S. GAAP, updating assumptions quarterly would create unnecessary volatility in the financial statements and would not necessarily be representative of a change in economic conditions. Many users suggested that reporting entities should update assumptions only when certain changes are determined to be persistent, and some users suggested that assumptions should be updated annually.

6. Overall, the majority of users supported only targeted improvements to existing U.S. GAAP for long-duration contracts, such as enhancing the disclosure requirements and permitting reporting entities to update assumptions more frequently, as discussed above. Many users noted that current U.S. GAAP has multiple accounting models for long-duration products that are similar in nature, which cause issues with the comparability of financial statements.

7. Users also stated that the existing U.S. GAAP accounting model for short-duration contracts works well and that the Board should not make any changes to existing guidance other than minor additions to required disclosures.

8. Below is a discussion of the feedback received in the following categories:

   (a) Volatility

   (b) Presentation and Disclosures

   (c) Comparability

   (d) Other Comments.

Volatility

9. Users were concerned with the potential volatility in the financial statements that may result from applying the guidance in the proposed Update. Many users agree that a current measure of the insurance contract liabilities would be useful; however, the volatility created by quarterly changes in assumptions would add complexity to the financial statements, would be costly to some users, and may not be representative of the underlying economics of the insurance business and would, therefore, be misleading to investors given the long-duration nature of the liabilities and the relative stability of predicting payouts. Specific user comments about volatility included the following:

   (a) Increased volatility would hinder the ability to separate temporary market-related disruptions from more significant changes to the underlying economics of the insurer.

   (b) Volatility created in net income due to quarterly changes in assumptions and in other comprehensive income (OCI) due to quarterly changes in discount rates would be costly to some analysts because changes would need to be unwound to calculate normalized earnings for their analyses.

   (c) Updating assumptions periodically is an improvement over existing U.S. GAAP, which does not require reporting entities to unlock assumptions until a premium deficiency is evident. However, assumptions should be updated only when conditions are persistent.

   (d) Assumptions should be updated less frequently than quarterly, such as on an annual basis.

(e) Requiring reporting entities to update assumptions on a quarterly basis would not only add volatility to the insurance-related balances but would introduce more subjectivity. If assumption changes are frequently made, it would be difficult to evaluate the validity of those assumption changes.

(f) One buy-side analyst stated that updating insurance liabilities for changes in discount rates is not useful because life insurers are unable to exit the liability. Market inputs are not the best way to determine the value of long-term liabilities given the volatility of those market inputs compared with the more stable cash flows of an insurer.

Unlocking the Margin

10. Many users supported unlocking the margin for changes in fulfillment cash flows due to changes in assumptions (other than changes in the discount rates) because it would remove the immediate impact on net income (to the extent there is a margin remaining on the statement of financial position). Some users think that the requirement in the proposed Update to recognize changes in fulfillment cash flows due to changes in assumptions (other than changes in the discount rates) in net income may incentivize management to make conservative assumptions at the inception of a contract (or a portfolio of contracts) and then recognize a subsequent gain when the assumptions are changed. Finally, many users supported the requirement in the proposed Update to disclose information about the assumptions used in estimating the insurance-related balances because they provide increased transparency into the estimation process.

Discount Rates and Discounting

11. Some users stated that for long-duration contracts, the discounting concept was an improvement to current U.S. GAAP because analysts currently have limited visibility into a reporting entity's interest rate risk. Other users recommended that instead of showing discounted amounts on the face of the financial statements, reporting entities should include discounted amounts in the notes to the financial statements along with the impact discounting would have on reserves, benefit/claim payments, and premiums. For those users, that would provide useful information without the complexity and volatility on the face of the financial statements that would be caused by discounting. Finally, a few users

think that the requirement to discount insurance contract assets and liabilities would not provide decision-useful information, because those users perform independent discounting analyses with observable market rates.

12. Some users who supported discounting the insurance contact assets and liabilities recommended that reporting entities be given an option to recognize changes in fulfillment cash flows due to changes in the discount rate either in OCI or in net income. Those users noted that the guidance in the proposed Update may cause accounting mismatches if an entity only holds securities classified as trading with fair value changes recognized in net income. Many users also stated that updating discount rates on a quarterly basis would cause additional volatility in the financial statements. Some users recommended that discount rates should be updated only when determined to be persistent and should then be recognized in earnings. Finally, the users who supported discounting were concerned that the lack of prescriptive guidance in the proposed Update for calculating the discount rates would create issues with financial statement comparability, because reporting entities with similar products may calculate the discount rates differently.

13. Many users stated that requiring property and casualty companies to discount the insurance-related amounts would not add value to the financial statements and would be a hindrance for both users and insurers.

14. Some users stated that they would likely unwind the effects of discounting, which would add significant time and costs to their analyses and add complexity to financial statement forecasting.

Impact on Key Performance Indicators

15. Overall, users stated that the volatility created in financial statements by applying the guidance in the proposed Update would significantly affect how users conduct analyses and create trend information, and would greatly impact key performance indicators that are relied upon today to make valuation and investment decisions. Specifically, users commented that the return on equity ratio would be significantly impacted by the guidance in the proposed Update, because returns would reflect different earnings patterns and the equity base would shift with changes in observable market information.

Furthermore, recording changes in fulfillment cash flows due to changes in assumptions in net income and changes in fulfillment cash flows due to changes in the discount rates through OCI would cause volatility in the numerator and the denominator of the ratio. Subsequent changes in assumptions may cause analysts to make revisions to prior period ratios to create more accurate trending information, which would be very burdensome. Some users also stated that this increased volatility would create uncertainty within the industry, leading to a higher cost of capital and less willingness to invest in the industry.

Presentation and Disclosures

Presentation

16. Most users preferred the current financial statement presentation, and stated that the financial statement presentation required by the proposed Update is difficult to understand and would further isolate insurance entities from entities in other sectors. Many users stated that volume information is important in their analyses (for example, premiums, investment income, and benefits and losses incurred) and they are concerned that this information would either no longer be meaningful or no longer be available on the statement of comprehensive income. While the information may be provided in the footnotes or by reporting entities through supplemental information included with earnings releases, the presentation changes would add an additional layer of complexity to an industry that is already complex. Finally, a few users requested that the Board provide a comprehensive example of an entity's financial statements presented in accordance with the guidance in the proposed Update, so that users can more easily assess the impacts of the guidance in the proposed Update on their models and analyses.

Disclosures

17. In general, users supported many of the disclosure requirements in the proposed Update and they think that those disclosure requirements are an improvement over existing U.S. GAAP. Users stated they currently rely on information obtained from various sources other than the U.S. GAAP financial statements such as supplemental schedules provided by reporting entities and U.S. statutory filings. Requiring additional disclosures such as U.S. statutory Schedule P information (on an undiscounted basis) would improve the

decision usefulness of the financial statements. Some users also supported the disclosures that would increase the transparency of management's significant estimates such as the discount rates used, the method used to calculate the discount rate (for example, the top-down or bottom-up approach), and the effects of discounting on the fulfillment cash flows and sensitivity analyses that illustrate how changes in the interest rate environment could impact future cash flows.

18. Some users also recommended that the guidance in the proposed Update require disclosures about how the unbiased, probability-weighted estimate of future cash flows is determined. Users questioned how current "best estimates" determined under existing U.S. GAAP would differ from the unbiased, probability-weighted estimates determined in accordance with the guidance in the proposed Update. Providing additional transparency about how those estimates are determined and what methods, judgments, and assumptions are used would provide analysts with more decision-useful information, because the benefit and loss reserve estimates could be more subject to management bias when there is little or no requirement to disclose the methodology used to determine the amounts.

Comparability

19. Most users discussed that the guidance in the proposed Update would reduce the ability of analysts to compare insurance entities to entities in other sectors and would impede both historical comparability and trend analysis. Some users stated that comparability within the sector and to other sectors within the financial services industry should be a key objective of the Board, because the loss of comparability would further segregate the insurance industry and would potentially lead to even less capital allocation to the insurance sector. Specific user comments about comparability included the following:

(a) The ability to compare insurance entities to entities in other sectors is important, because in many cases generalists are making investment decisions or the insurance sector is covered by an analyst who also has responsibility for the financial services sector.

(b) One user stated that requiring an insurance company to estimate the future expected cash outflows could be unreliable, highly judgmental, and not comparable to the guidance applicable to the banking industry, which many users consider the most closely comparable sector to the insurance sector. The guidance in the proposed Update would require an insurer to estimate the potential timing and amount of a future pay out and the present value of that potential pay out to record a liability at the inception of a contract, whereas banks set up general reserves for potential losses on loan portfolios without considering the effects of time. Also, in the proposed Update, preparers would recognize premiums receivable and insurance contracts liabilities at their discounted value on the basis of an unbiased, probability-weighted mean while under the current banking guidance, financial institutions would recognize loan balances at amortized cost less an allowance.

(c) Comparing the insurance sector to the banking sector would be challenging and the differences would be difficult to explain to analysts and potential investors.

(d) There are reservations about the transition requirements in the proposed Update because of the loss of historical data that has been collected over the course of the last few decades. The proposed transition requirements would create subjectivity in the accounting estimates and issues with the comparability of prior-period financial statements and would compromise the comparability of future financial results.

(e) The Board should reconsider the impacts of the proposed Update on the comparability between insurance providers and noninsurance institutions such as banks.

(f) Assumptions and any risk adjustments should only be disclosed to preserve historical financial information for comparability and trend analyses and to increase the transparency of the assumptions used by management.

OTHER COMMENTS

20. Most users commented that while the Board’s efforts to achieve a converged insurance contracts standard with the IASB are appreciated, convergence with the IASB is secondary to retaining high-quality accounting guidance and improving existing U.S. GAAP. Many users strongly recommended that the Board make only targeted

improvements to U.S. GAAP to address certain issues as opposed to overhauling the insurance contracts guidance in its entirety.

21. One sell-side analyst commented that buy-side analysts would require more time to assess the impacts of the guidance in the proposed Update than sell-side analysts, because buy-side analysts typically have larger portfolios (50-60 companies) than sell-side analysts (10-15 companies).