FASB/IASB Insurance Accounting Project

Actuaries' Club of Hartford & Springfield

2014 Annual Meeting

May 21, 2014

Rowen B. Bell, FSA, MAAA

A Health Actuary's Journey…

The Hobbit, or There And Back Again

- J.R.R. Tolkien

A Health Actuary's Journey…

"Lately it occurs to me: What a long, strange trip it's been…."

- The Grateful Dead, *Truckin'*

A Health Actuary's Journey…

IASB Discussion Paper / FASB ITC

- 2007 talk at SOA Health Meeting (Seattle)
- 2008 paper in SOA Actuarial Practice Forum

FASB Discussion Paper / IASB ED

- 2010 talk at SOA Valuation Actuary Symposium (Chicago)

FASB Exposure Draft / IASB Revised ED

- 2013 talk at SOA Annual Meeting (San Diego)

2007

- “Entity-specific cash flows”
  - Accounting model was “current exit value”
  - Under current exit value, liability measurement was supposed to exclude impact of cash flows that would not arise for another entity holding the same obligation
  - Are provider discounts examples of entity-specific cash flows?   And if so, how would that impact claim liability measurement?

2007

- "Guaranteed Insurability"
  - At this time, guaranteed insurability (GI) was the main criterion for determining which premiums/claims to include (and which to exclude) in liability calculation
  - Defined as "a right that permits continued coverage without reconfirmation of the policyholder's risk profile and at a price that is contractually constrained"
  - What impacts "contractually constrained"?
    - Regulatory caps on rate increases?
    - Voluntary (i.e., non-regulatory) rate guarantees?

2007

- Claim liability calculation
  - Explicit cash flows (i.e., may need to formally complete the triangle, not just project ultimate incurreds)
  - Multiple scenarios with probability weights?
  - Discounting
  - Margins [see 2008]

2007

- “Pre-claims liability” calculation
  - Analogous to active life reserves from long-duration contracts – but, pertinent to short-duration as well
  - Intra-year claims seasonality + level premiums = non-zero current exit value of portfolio
  - PCL as a vehicle for smoothing the expected emergence of profit over the policy year
  - PCL oscillation between positive and negative
  - PCL balance for a portfolio dependent on mix of business by renewal date, and on benefit seasonality

2008

- Margin in claims liability under current exit value
  - Risk margin vs. service margin
  - Calibration of margins to premiums, as a means of avoiding recognition of gains at issuance
- Current practice = % of base liability estimate
- Bell's formula (now obsolete!) for claim liability margins had the following characteristics:
  - Expected compensation for non-risk services for a specific coverage month is recognized as claims paid
  - Expected compensation for risk for a specific coverage month is recognized in proportion to release from risk
  - Calibrate margins to pricing profit target

2008

- Inputs to Bell's formula:
  - Pricing profit margin, decomposed into portion for bearing risk and portion for non-risk services (i.e., services an ASO customer would receive)
  - Vector of "risk release factors", reflecting how the insurer's ability to estimate the ultimate incurred claims for a given month evolves over time
  - The liability estimate before margin is an input to the service component; corresponding input to the risk component is the ultimate incurreds
- Higher implied margins than current practice

2010

- Move from “current exit value” to “current fulfillment value” as accounting model
  - Took “entity-specific cash flows” concerns off table
- “Guaranteed insurability” criterion replaced with new definition of “contract boundary”
  - “The point at which the insurer either

    (a) is no longer required to provide coverage, or

    (b) has the right or practical ability to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk”

2010

- Movement towards two distinct models (today called BBA vs. PAA)
  - Length of coverage period, defined via contract boundary, is key to determining which model to use
  - Measurement & presentation differences between the two models
- In the "short-duration" model, no pre-claims liability, but instead a notion of unearned premium reserve
  - More like P&C UEPR than typical health UEPR
  - Rev rec can be non-linear to reflect expected pattern of incurred claims timing

2010

- New issue: Unbundling (aka bifurcation)
  - Situation where an insurance contract has a component that would be accounted for under a separate standard if it were a standalone contract, and is “not closely related to the insurance coverage”
  - Need to “unbundle” that component and account for it separately
  - So – for health insurance, are the claims admin & network services (i.e., the portions of the contract that would get sold separately as ASO) “closely related” to the insurance coverage?

2013

- Contract boundary definition – resolution
  - New criterion that looks at the portfolio (not just the policy) and the entity's right or practical ability to reassess the portfolio's risk and set a price or level of benefits that reflects that risk
  - Generally speaking, it works, i.e.:
    - Products where premium structure involves prefunding use the BBA (long-duration model)
    - Products where each year's premiums are intended to stand alone use the PAA (short-duration model)
  - Concerns about multi-year rate guarantees

2013

- Liability for incurred claims
  - A hybrid of IBNR and LAE
  - But, no margin! – All expected profit intended to be recognized over coverage period, not over coverage period + claims settlement period
- Liability for remaining coverage
  - Like UEPR, but covering the entire contract period, with an offsetting asset for future premiums
  - Change in LRC is vehicle for recognizing revenue
  - Can have non-level rev rec to match claims timing

2013

- "Estimated returnable amounts"
  - An amount that the insurer is required to repay the policyholder/beneficiary, independent of whether an insured event occurs
  - An ERA gets removed from income statement, but remains on balance sheet
  - Classical example = CSV of whole life policy
  - However: Contractual experience refunding mechanisms are deemed to give rise to ERAs
  - What about similar regulatory mechanisms, e.g., ACA MLR rebate requirements?

A Health Actuary's Journey…

"After changes upon changes, we are more or less the same…"

- Simon & Garfunkel, *The Boxer*

A Health Actuary's Journey…

- February 2014: FASB votes 5-2 to pare back the insurance contracts project
  - "Targeted improvements" to US GAAP, rather than attempted integration with IASB standard
  - For short-duration contracts, "the Board decided to limit the targeted improvements to enhanced disclosures"

A Health Actuary's Journey…

Dr. Strangelove, or How I Learned To Stop Worrying And Love Current US GAAP

- with apologies to Stanley Kubrick

A Health Actuary's Journey…

Much Ado About Nothing

- William Shakespeare