Accounting and Actuarial Issues
Recent and Pending Changes to Accounting Rules

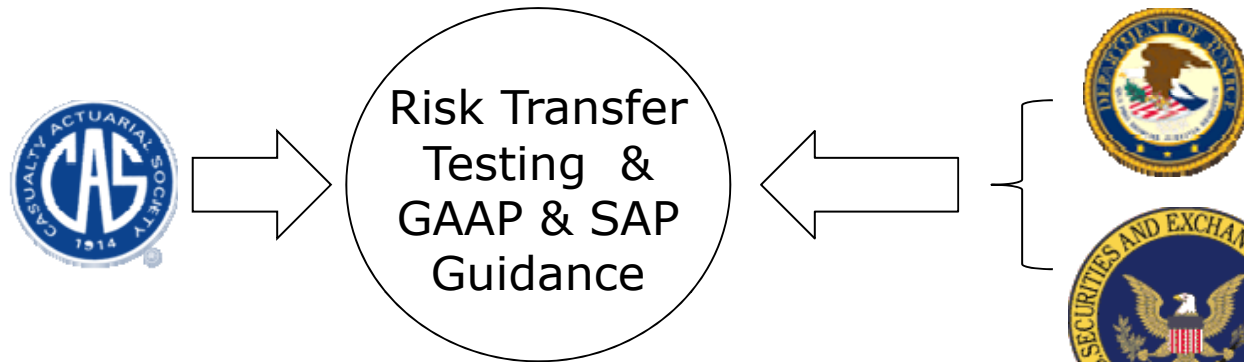## Myles Tilley, CPA

Managing Director
Insurance Resolutions, Inc.

Accounting Developments:
Risk Transfer problems put pressure on guidance

Risk Transfer Testing & GAAP & SAP Guidance

Standard Setters

FINANCIAL ACCOUNTING STANDARDS BOARD

NAIC
National Association of
Insurance Commissioners

Risk Transfer Efforts:

- NAIC Annual Statement Disclosure Enhancements (2005)
- CAS "Risk Transfer Analysis & Testing" research paper (2005)
- FASB Risk Transfer Project (2005 – 2008)
- FASB Invitation to Comment "*Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting*" (2006)

Accounting Developments:
International Accounting Standards

Standard Setter

- International Accounting Standards Board (IASB) issues Phase I IFRS 4 – "*Insurance Contracts*" (2004)
- FASB issues Invitation to Comment "*An FASB Agenda Proposal: Accounting for Insurance Contracts by Insurers and Policyholders, including the IASB Discussion Paper, Preliminary Views on Insurance Contracts*" (2007)
- FASB announces joint Insurance Contracts Project with IASB to create Phase II IFRS 4 - "*Insurance Contracts*" (2008)
- SEC issues "*Roadmap to Convergence*" (2008)

Leading to:

- By 2014 – Phase II IFRS 4 will likely replace GAAP for Insurance Contracts
- Four year transition is preferred

Accounting Developments:
Impacts of Phase II IFRS 4 "Insurance Contracts"

Standard Setter

International Accounting Standards Board®

- ❑ Technical
    - Scope
    - Approach; Accounting Models
    - Liability Measurement (Discounting)
    - Policy Acquisition Costs
    - Bifurcating (Unbundling)
    - Statutory Accounting

- ❑ Cultural
    - More Principles based than Rules based
    - Role of the Actuary

Accounting Developments:
Other NAIC Activity

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NAIC
National Association of
Insurance Commissioners

- Model Audit Rule
- Solvency Regulation : Impact of Solvency II
- Reinsurance Regulatory Modernization

Accounting and Actuarial Issues
Actuarial Concerns with the Economy

Noelle Fries, FCAS
Consulting Actuary
Insurance Resolutions, Inc.

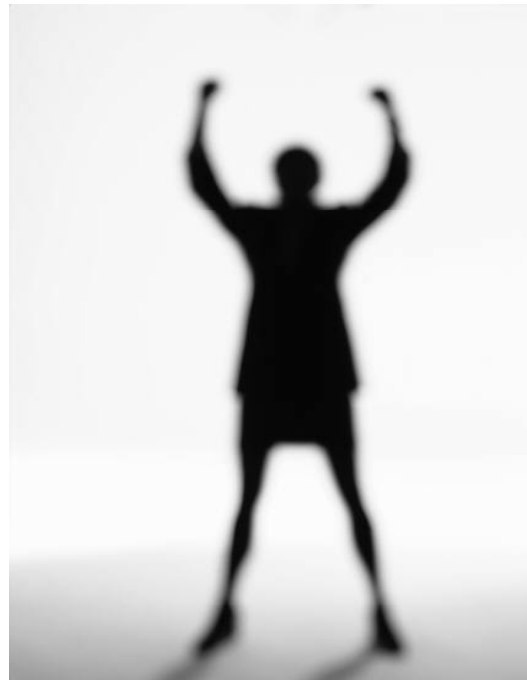# Actuarial Issues
Continuation of Risk Transfer Testing

- **Expected Reinsurer Deficit (ERD):**
  - ERD = (p*T)/P
    - p = probability of net economic loss
    - T = average severity of net economic loss (when it occurs)
    - P = expected premium
  - Economic loss considers:
    - All components of business captured including loss, expense and investment income
    - At NPV
  - Mathematically, "10-10" rule corresponds to a 1% ERD rule
- **Risk Coverage Ratio (RCR):**
  - Risk/Return measure
  - RCR = (p*T)/E[G]
    - E[G] = expected economic gain across all possibilities
- **Right-tailed Deviation (RTD):**
  - RTD(x) = E*(x) – E(x)
  - Risk transfer exists if β*RTD(x) > contract premium

Actuarial Issues

SUPER-CRUNCHERS

Actuarial Issues
Behavioral Economics

- Examples of Cognitive and Behavioral Biases
  - Anchoring
  - Framing
  - Loss Aversion
  - Endowment Effect
  - Availability Heuristic
  - Status Quo Bias
  - Optimism Bias
  - Herd Behavior

Actuarial Issues
What's an Actuary to do?

- Predictive Modeling
- Choice Architecture
- Consumer side versus Insurance Management side of behavioral economics