



PolySystems, Inc.

HORIZONS

November 2009

Issue #54
Copyright © 2009
PolySystems, Inc.

EDITOR
Jackie Smith

ASST. EDITOR
Tom Cook

PRODUCTION
Debbie Christensen

CHICAGO OFFICE
30 N. LaSalle Street
Suite 3600
Chicago, IL 60602
P 312.332.5670
F 312.332.2391

NJ OFFICE
2 Executive Campus
Suite 320
Cherry Hill, NJ 08002
P 312.332.5670
F 856.663.8712

www.polysystems.com

Happy
Thanksgiving
from
PolySystems!



The Latest from the Int'l Front

—Douglas S. Van Dam, FSA, MAAA, CLU, ChFC, Manager, Actuarial Services

In our January 2009 newsletter, I updated you on International Financial Reporting Standards. At the time, I reported the International Accounting Standards Board (IASB) was spending a lot of time thinking about measurement attributes. Here in November, the IASB is still spending a lot of time thinking about measurement attributes.

Measurement of Liabilities

In September, the IASB voted narrowly in favor of a Modified IAS 37 measurement attribute. A minority of the IASB supports a Fulfillment Value measurement attribute.

Under **Modified IAS 37** (IAS 37 modified to exclude day one gains), liabilities would be measured as the amount an entity would rationally pay to be relieved of the present obligation, or the lower of: (1) the value to the entity of not having to fulfill the obligation, (2) the amount that the entity would have to pay to the counter-party to cancel the obligation, or (3) the amount that would have to be paid to a third party to transfer it to a third party.

An entity estimates the value of not having to fulfill an obligation using the three building blocks from the original insurance discussion paper: probability weighted cash flows, time value of money, and risk margins (the amount the entity would pay on top of the discounted cash flows to be rid of the uncertainty of the cash flows). For insurance policies, a residual margin is added so there is no gain at issue.

Under **Fulfillment Value**, liabilities would be measured as the expected present value of the cost of fulfilling the obligation to the policyholder over time. Fulfillment Value uses the same cash flows and discount rates as the Modified IAS 37 model, but it has a composite margin, which is the amount needed on top of the discounted cash flows to avoid a gain at issue. There is no separately calculated risk margin.

An Exposure Draft would likely explain both methods.

The FASB is Working with the IASB Toward a Single Standard

On Wednesday, October 28, 2009, the FASB and IASB met jointly and discussed insurance for two hours. Most of the discussion was about

two areas where the Boards had previously disagreed: the measurement attribute (and the role of risk margins in the measurement attribute) and the treatment of acquisition costs.

In its July meetings, the FASB was not convinced about the appropriateness of a risk margin or that a risk margin could be measured. Now the FASB is much more open to the concept. The following example seems to have changed its mind:

Assume the insurance company issues two policies with the same expected cash flows, however one of the policies has a much fatter tail. Since individuals and companies are risk adverse, there will be a higher price charged for the policy with the fatter tail, even though the expected loss on the two policies is the same.

This difference in price is exactly what the IASB is trying to address with the IAS 37 model. The FASB does not like the language of IAS 37, but it appears the FASB is currently in agreement conceptually with the IASB on the risk margin as one of the building blocks of insurance liabilities.

When the discussion moved to the treatment of acquisition costs, compromise was still in the air. The FASB has maintained that revenue should not be recognized to offset acquisition costs. After the discussions, the IASB voted to reverse its earlier decision and decided acquisition costs should be expensed in the period they are incurred. While there is no DAC, the liability can be thought of as current GAAP net liability. If acquisition costs vary from year to year, however, there is an immediate impact on the bottom line.

The IASB has Reached Tentative Decisions on Some Topics

- The cash flows, discount rates, and risk margins should be current assumptions for each reporting period.
- The residual, or composite margin, is released over the contract period.
- The Exposure Draft will not give detailed guidance on discount rates. All assumptions should be as market consistent



as possible. This means the discount rates will probably be the risk free rates or the risk free rates plus a liquidity margin.

Other IASB Topics Still Not Decided as of the October 2009 IASB Board Meeting

Unbundling refers to the splitting of an insurance contract into pieces and valuing the different pieces under different standards. The IASB wants to make a decision on whether insurance contracts should be unbundled.

Presentation is the geography of the income statement. The IASB discussions have focused on how an insurance company recognizes revenue. The decisions made regarding presentation will impact what is recognized as costs or expenses. In each of the proposed models, supposedly, the annual profit would not be affected.

If a policy has a cash value, a **deposit floor** would mean the liability can never be less than the cash value even if expected lapse rates are zero. We would have to compare the otherwise computed liability to the cash value and pick the higher amount.

Future board meetings will also likely cover participating, unit-linked (a.k.a. variable), index-linked and universal life contracts; business combinations (PGAAP); and embedded derivatives.

IASB Timeline

The staff of the IASB proposed moving the release date of an Exposure Draft from December 2009 to April 2010. Comments on the Exposure Draft are due in August 2010. The IASB is still planning on an adoption date of June 2011. Canada, Korea, and India will all move to IFRS in 2011.

PolySystems Will Continue to Follow all International Developments

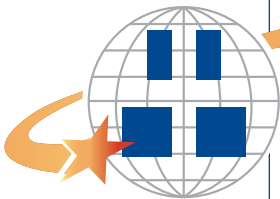
We recently added an “International Update” section to our website. I listen to the IASB meetings and attend the IAA conferences. After each meeting I prepare a summary of the items discussed. All of my notes will now be posted on our website and distributed via email to our LHATF distribution list. (If you are uncertain whether you are on our LHATF distribution list, email Jackie Smith at JSmith@PolySystems.com to ensure you receive the latest International Updates.)

As we wait for a final standard, it is a good time to improve your stochastic projection process. PolySystems’ stochastic projection capabilities are fully integrated with the valuation platform, and a strong valuation and projection engine will be beneficial for all of the work that you will do. Additionally, our cache of stochastic tools bring speed, flexibility and, most importantly, control to the stochastic process.

Measure is PolySystems’ experience study system, and it is available for all lines of business. Experience reporting capabilities will help you develop current estimates.

Contact Bob Keating at BKeating@PolySystems.com or 312.332.5670 for more information about how PolySystems can help you prepare for IFRS.

Feel free to contact me with your questions about IFRS and the work of the IASB at DVanDam@PolySystems.com. Now I am off to catch my flight to Hyderabad, India for the semi-annual meeting of the International Actuarial Association... 🌐



BITS & BYTES **A Flurry of New Features on the Web!**

—Jackie Smith, Actuarial Assistant

This is the time of year when the word “flurry” starts to pop up in Chicago’s weather forecasts. The word is exciting for some and makes other people groan. While I do not get excited about winter, I am excited about the flurry of new features on PolySystems’ website!

The headline article in this month’s newsletter already mentioned the new “International Update” page. Look for the “International Update” link on our home page.

There is another new link (and button) on the home page called “New Feature Announcements.” Software Changes and Features Reports are produced once per quarter, however we release new features all the time. You can now check our website to learn about some of the new features that have been released since last quarter’s Software Changes and Features Reports.

Contact your PolySystems support actuary or Bob Keating to request updated software.

If that is not enough to bring you to our website, we have even more exciting features on the horizon. Stay tuned (and check the website) for an exciting new way to access your quarterly Software Changes and Features Reports, our 2010 training class schedule and a look back as PolySystems celebrates its 40th anniversary!

Finally, thanks to everybody who stopped by our booth and hospitality suite at the SoA Annual Meeting in Boston, MA. It was a pleasure seeing you again. Our 2010 meeting schedule is now posted on, you guessed it, our website!

Until then, visit us at www.PolySystems.com. As *30 Rock’s* Liz Lemon would say, “I want to go to there.” 🌐