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Short-Duration Contract Disclosures for Private Companies

How Public Companies Have Paved the Way

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The Financial Accounting Standards Board's (FASB's) updated accounting standard for insurance companies that issue short-duration contracts takes effect for private companies at the end of 2017. As private companies gear up for newly required disclosures, they can take guidance from how public companies, for which the standard already has taken effect, have implemented the standard.

FASB Accounting Standards Update (ASU) No. 2015-09, "Financial Services – Insurance (Topic 944): Disclosures About Short-Duration Contracts," will require several additional disclosures related to claim liabilities. The ASU has been in work for several years, and insurance companies understandably have been eager to learn how it will translate in practice. A review of the financial statements of 15 public insurance companies with $75 million to $500 million in premiums provides some clues.

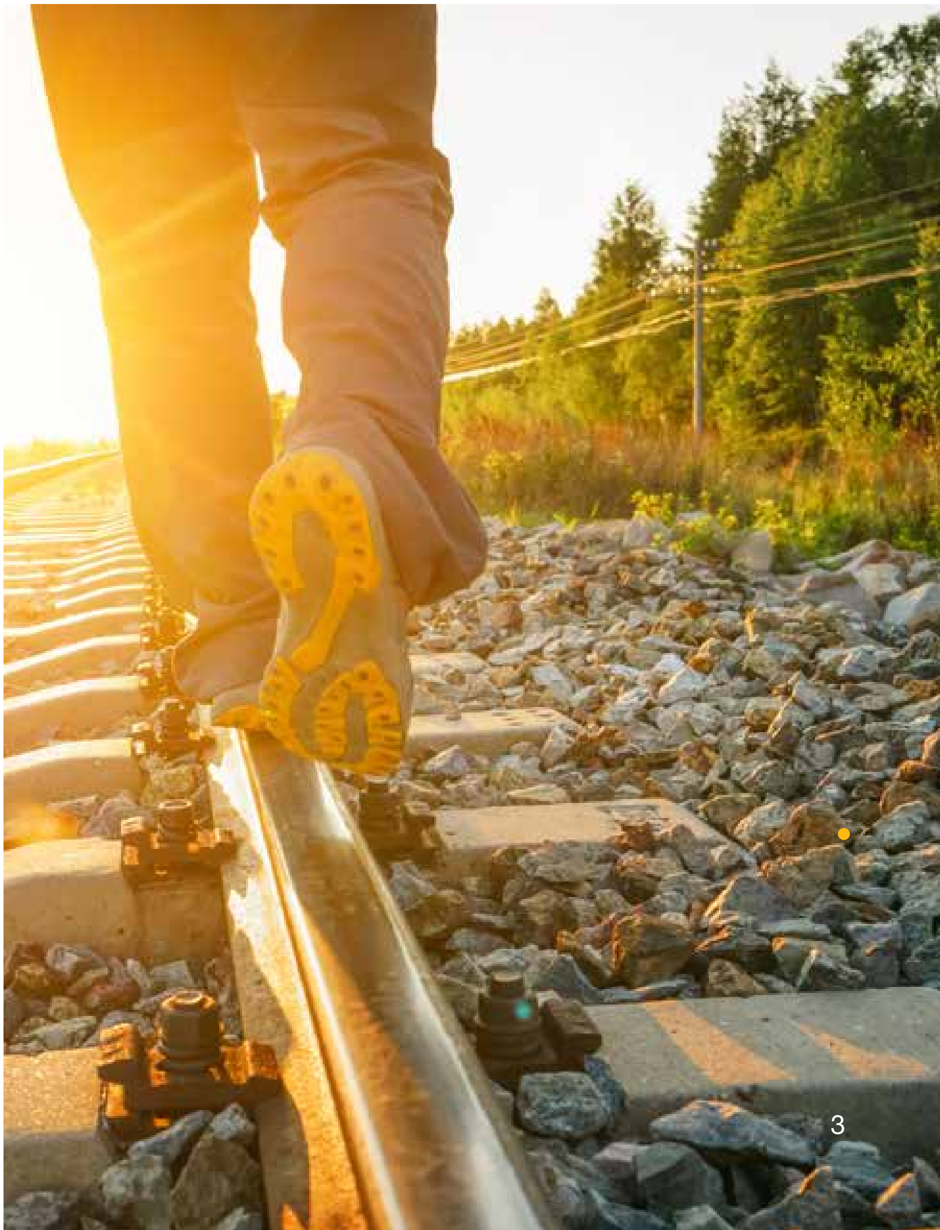
The ASU's Genesis

In October 2008, the FASB and the International Accounting Standards Board (IASB) launched a joint project to improve the accounting for insurance contracts, both long- and short-duration.

In June 2013, the two organizations issued separate proposed amendments that converged on most issues but still contained several differences. As issued, the FASB exposure draft would have resulted in a new accounting model for short-duration contracts. The draft received overwhelming feedback that supported the recognition and measurement guidance for short-duration contracts under existing U.S. generally accepted accounting principles (GAAP). As a result of this feedback, the FASB ultimately focused its changes to targeted improvements in existing U.S. GAAP. Financial statement users also indicated that additional disclosures about the claim liabilities would improve the transparency of significant estimates made in measuring those liabilities and give additional insight into an insurer's ability to underwrite and anticipate costs associated with claims.

In response, the board issued guidance limited to enhancements to the required disclosures. ASU 2015-09 focuses on providing additional information about claim liabilities to help financial statement users better understand the nature, amount, timing, and uncertainty of cash flows related to claim liabilities and the development of the claim liability estimates.

With the effective date looming on the horizon, private insurance companies must familiarize themselves with the ASU's requirements and potential alternatives.



The New Disclosure Requirements

The ASU imposes five new main requirements under three categories: claim development tables, frequency and severity, and claims duration.

Claim Development Tables

1. Tables presenting incurred and paid claims (see Exhibits 1 and 2), with allocated claim adjustment expense for each, by accident year. The tables must be presented on a disaggregated basis (for example, by line of business, product line, or geographic location), net of reinsurance, and without discounts. The disaggregation method chosen will determine how many tables a company must include as disclosures. The tables should cover the number of years for which claims incurred typically remain outstanding but need not exceed 10 years, including the most recent reporting period covered in the balance sheet. Each period before the current reporting period is considered to be required supplementary information.

The ASU is careful not to prescribe any specific factor that must be used as the basis for disaggregating this or any of the disclosures. It specifies only that insurance companies should aggregate or disaggregate disclosures so useful information is not obscured by 1) the inclusion of a large amount of insignificant detail or 2) the aggregation of items with significantly different characteristics.

The following information (in Exhibit 1 and 2) is about incurred and paid claims development as of Dec. 31, 20Y6, net of reinsurance, as well as cumulative claim frequency and the total of incurred-but-not-reported liabilities plus expected development on reported claims included within the net incurred claims amounts.

The information about incurred and paid claims development for the years ended Dec. 31, 20X7, to 20Y5, is presented as supplementary information.

Public Company Insight: *Disclosures by public insurance companies have disaggregated the claims development information by line of business. Some have disaggregated by product line (for example, commercial or personal), but, overall, little deviation was found.*

In addition, most companies have presented 10 years of claims development information, with all the information appearing in financial statement footnotes. The footnotes include a narrative asterisk indicating that the previous years' information is required supplementary information and is unaudited.

Exhibit 1: ASU 2015-09 Table 1

Homeowners' Insurance *in thousands*
Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance

	For the Years Ended Dec. 31,										As of Dec. 31, 20Y6	
Accident Year	**20X7**	**20X8**	**20X9**	**20Y0**	**20Y1**	**20Y2**	**20Y3**	**20Y4**	**20Y5**	**20Y6**	**Total of Incurred-but-Not-Reported Liabilities Plus Expected Development on Reported Claims**	**Cumulative Number of Reported Claims**
20X7	$ 10,000	$ 9,900	$ 9,700	$ 9,800	$ 9,750	$ 9,750	$ 9,600	$ 9,650	$ 9,575	$ 9,550	$ 5	39
20X8		10,950	11,000	10,500	10,750	10,850	10,600	10,250	10,150	10,250	30	37
20X9			12,000	11,750	11,500	10,900	10,900	10,850	10,750	10,500	90	38
20Y0				12,250	12,500	12,550	12,400	12,200	12,150	12,000	300	36
20Y1					12,300	12,500	12,650	12,750	12,800	12,850	900	35
20Y2						12,800	12,900	12,750	12,700	12,700	1,100	34
20Y3							13,000	13,250	13,100	13,150	1,500	31
20Y4								13,150	13,250	13,300	2,100	29
20Y5									13,500	13,250	3,100	26
20Y6										13,750	5,000	22
									Total	**$ 121,300**		

Source: Financial Accounting Standards Board

Exhibit 2: ASU 2015-09 Table 2

Homeowners' Insurance *in thousands*
Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance

	For the Years Ended Dec. 31,									
Accident Year	**20X7**	**20X8**	**20X9**	**20Y0**	**20Y1**	**20Y2**	**20Y3**	**20Y4**	**20Y5**	**20Y6**
20X7	$ 3,000	$ 5,000	$ 5,500	$ 6,000	$ 6,800	$ 7,500	$ 8,500	$ 9,000	$ 9,050	$ 9,075
20X8		3,500	5,750	6,500	7,500	7,750	8,250	8,500	9,000	9,500
20X9			3,750	6,000	6,500	7,500	7,900	8,250	8,950	9,700
20Y0				3,750	6,250	7,250	7,750	8,900	9,700	9,950
20Y1					4,250	5,500	6,750	8,000	8,950	9,250
20Y2						4,125	5,250	7,000	8,000	9,000
20Y3							4,500	5,750	7,250	7,750
20Y4								4,600	6,000	6,950
20Y5									4,750	6,125
20Y6										4,850
									Total	$ 82,150
									All outstanding liabilities before 20X7, net of reinsurance	1,400
									Liabilities for claims and claim adjustment expenses, net of reinsurance	$ 40,550

Source: Financial Accounting Standards Board

2. Incurred and paid claims development tables reconciled to the amount of the aggregate carrying liability for unpaid claims and claim adjustment expenses presented on the statement of financial position (Exhibit 3). Separate disclosures are required for the reinsurance recoverable on unpaid claims for each disaggregated category and for each period presented on the statement of financial position.

Exhibit 3: ASU 2015-09 Table 3

Reconciliation of the Disclosure of Incurred and Paid Claims Development to the Liability for Unpaid Claims and Claim Adjustment Expenses

The reconciliation of the net incurred and paid claims development tables to the liability for claims and claim adjustment expenses in the consolidated statement of financial position is as follows.

	Dec. 31, 20Y6
Net outstanding liabilities	
Homeowners' insurance	$ 40,550
Other short-duration insurance lines	1,976
Liabilities for unpaid claims and claim adjustment expenses, net of reinsurance	42,526
Reinsurance recoverable on unpaid claims	
Homeowners' insurance	13,880
Other insurance lines	283
Total reinsurance recoverable on unpaid claims	14,163
Insurance lines other than short-duration	3,315
Unallocated claims adjustment expenses	2,420
Other	10
	5,745
Total gross liability for unpaid claims and claim adjustment expense	$ 62,434

Source: Financial Accounting Standards Board

Public Company Insight: *Disclosures by public entities have included reconciliation of net incurred and paid claims development tables to the liability for claims and claim adjustment expenses and reinsurance recoverable on unpaid claims for each disaggregated category. These disclosures are combined together in one table within the footnote disclosures, similar to presentation in the ASU disclosure in Exhibit 3.*

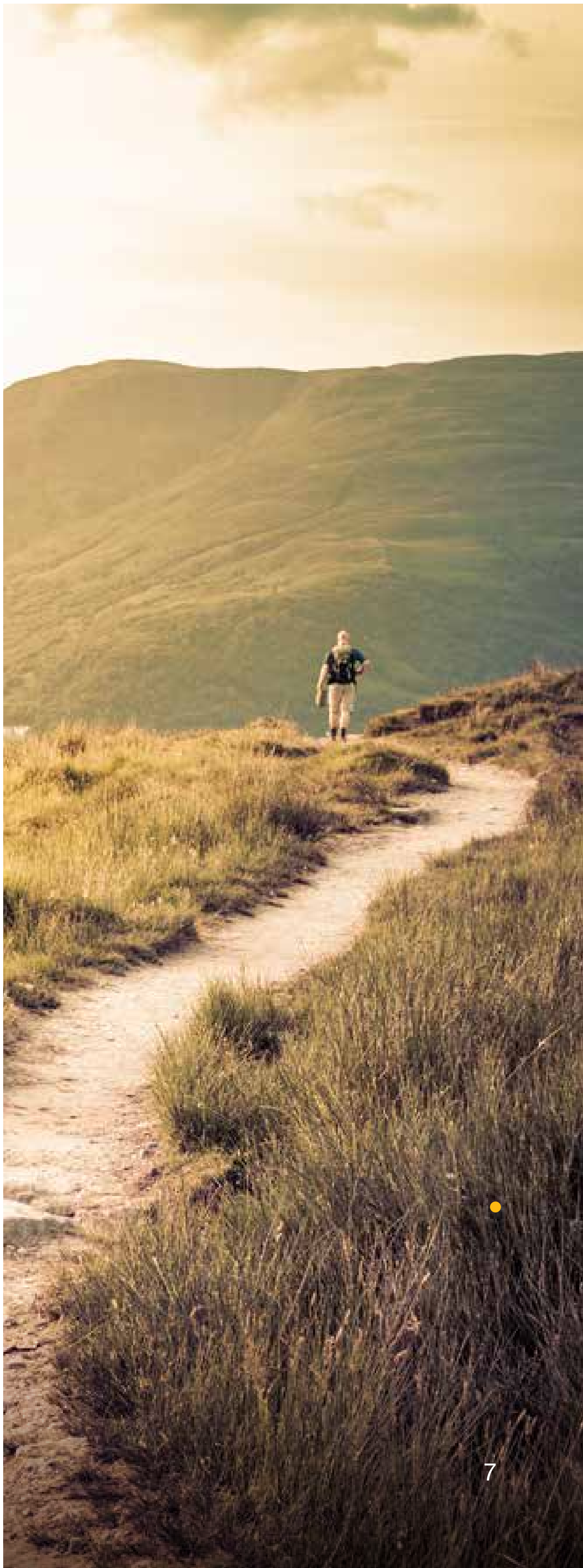
3. Total incurred-but-not reported (IBNR) liabilities. For each accident year in the incurred claims development information, companies should report the total IBNR liabilities plus expected development on reported claims included in the liability for unpaid claims and claim adjustment expenses, accompanied by a description of reserve methodologies (as well as any changes to those methodologies). (Exhibit 1).

Public Company Insight: *IBNR liabilities as well as expected development on reported claims were included within the 10-year table as presented within Exhibit 1 and therefore were presented disaggregated. The description of reserve methodologies disclosed by public entities seemed to vary. Some of the entities went into full descriptive detail and disclosed methodologies that would be used by an actuary, while other companies provided limited disclosure related to the methodologies used.*

Frequency and Severity

4. Disaggregated quantitative information about the frequency of reported claims for each accident year in the claims development tables (Exhibit 1). The company also must include a qualitative description of the methodologies used to determine claim frequency information, as well as any changes to the methodologies.

Public Company Insight: *Quantitative claim frequency was included within the 10-year table as presented within Exhibit 1. The qualitative description of claim frequency disclosed by public companies seemed consistent, as it was simple but informative. This disclosure provides a definition of how a company would determine the existence of a claim.*



Claims Duration

5. Disaggregated history of claims. For all claims except health insurance claims, an insurance company must provide a disaggregated history of claims duration, presented as the average annual percentage payout of incurred claims by age, for the same number of accident years presented in requirements 1 and 2 (Exhibit 4).

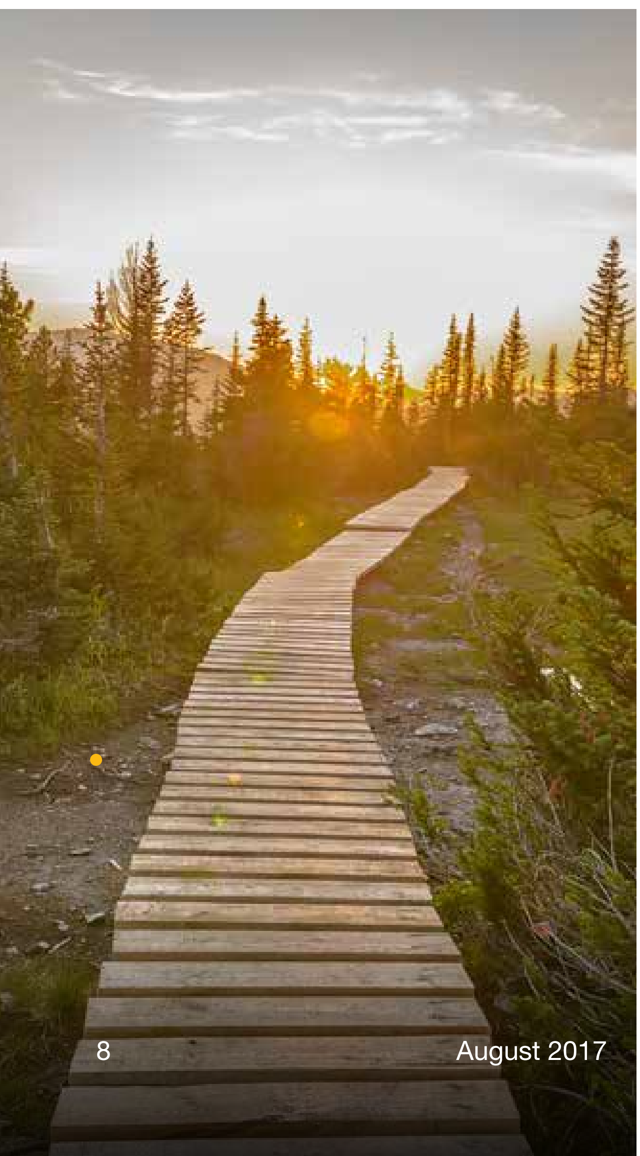
Exhibit 4: Information About Historical Claims Duration

The following is supplementary information about average historical claims duration as of Dec. 31, 20Y6.

Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance

Years	1	2	3	4	5	6	7	8	9	10
Homeowners' insurance	33.8%	14.9%	8.5%	7.2%	6.6%	4.9%	5.4%	5.7%	2.7%	0.3%

Source: Financial Accounting Standards Board



Public Company Insight: *This table was presented similarly with all public entities reviewed. The data was presented in a table following the tables described in requirements 1 and 2. This information was provided at the same level of disaggregation as the 10-year loss tables with a table for each disaggregation. The disclosure was included within the basic financial statements with an asterisk noting that only current years presented were audited and previous years disclosed were unaudited.*

ASU 2015-09 also requires additional disclosures about the effect of discounting the claims liabilities reported at present value, including:

- For each period in the balance sheet, the aggregate amount of discount for the time value of money deducted to derive the liability for unpaid claims and claim adjustment expenses
- For each period in the income statement, the amount of interest accretion recognized
- The line item(s) in the income statement where the interest accretion is classified

Statutory Update

At its spring 2017 meeting, after much deliberation and interested party feedback, the National Association of Insurance Commissioners Statutory Accounting Principles Working Group (NAIC SAPWG) voted to reject ASU 2015-09. However, the NAIC SAPWG did adopt revisions to Statutory Statement of Account Principle (SSAP) No. 55, "Unpaid Claims, Losses and Loss Adjustment Expenses," and SSAP No. 65, "Property and Casualty Contracts," that would incorporate some of the disclosure requirements required under U.S. GAAP in ASU 2015-09. Specifically, the disclosures adopted include the following:

- Information about significant changes in methodologies and assumptions used in calculating the liability for unpaid claims and claim adjustment expenses, including the reasons for the change and the effects on the financial statements for the most recent reporting period presented
- The amount of interest accretion recognized in the income statement and the line item(s) in the income statement where the interest accretion is classified

In addition to the NAIC's rejection of ASU 2015-09, the American Institute of CPAs also has revised the audit standards under AU-C 800 related to an auditor's evaluation of pertinent GAAP disclosures on special purpose financial statements such as NAIC statutory financial statements. Specifically, GAAP disclosure requirements that have been wholly or partially rejected by the NAIC would not need to be evaluated by the auditor in order to determine whether the annual audited statutory financial statements achieve fair presentation in accordance with the insurance statutory basis of accounting. However, if the NAIC has not finalized action on GAAP disclosure requirements, an auditor would need to assess whether informative disclosure in the annual audited financial statements would be needed to achieve fair presentation. As a result, insurance companies that file NAIC statutory basis financial statements and their auditors no longer will need to assess GAAP disclosure requirements that have been rejected by the NAIC.

Preparing for Year-End Close and Financial Statement Audit

Private insurance companies should begin preparing now for adoption of ASU 2015-09 disclosures. Compiling the necessary data will require collaboration among the claims department, actuaries, and others in the company. Procedures and processes must be developed to facilitate the capture of accurate data that can be disaggregated or aggregated as necessary and reconciled. Companies need to assess the level of disaggregation or aggregation appropriate for their businesses. This level will vary from company to company, but management should establish and consistently apply a policy that provides financial statement users with the most relevant information.

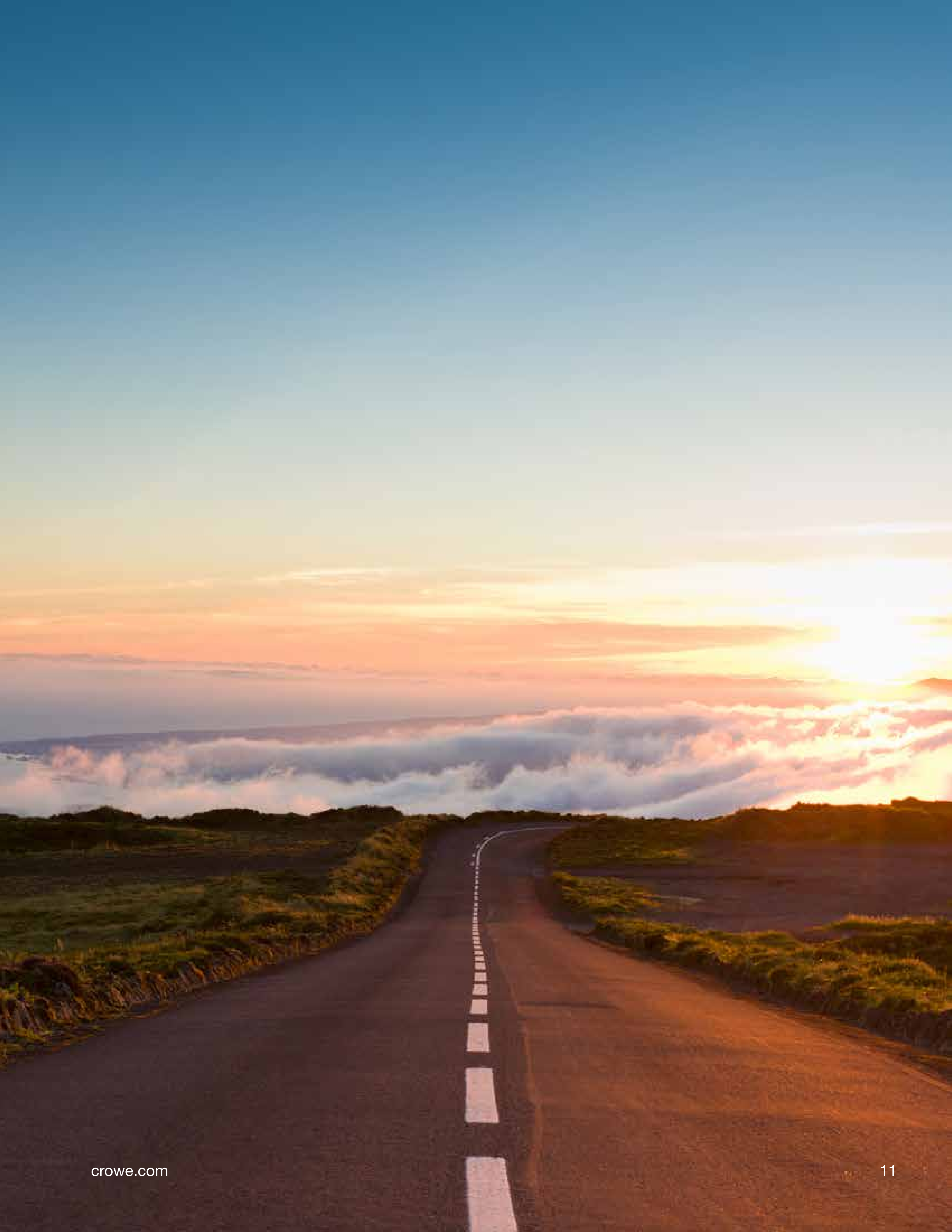
Insurance companies also should think about how the new standard will affect their annual audits. Audit preparation should include determining the amount of data to be audited and collecting disclosure-related information in a timely manner and what support the auditors will require.

Under the auditing standards of the Public Company Accounting Oversight Board (PCAOB) and the AICPA, the disclosures presented for all periods preceding the most recent period are considered required supplementary information. As such, auditors are required to perform only certain limited procedures to the information. The required supplementary information may be presented as supplementary information outside the financial statements or as part of the footnotes to the basic financials. If not audited, the required supplementary information should be marked as unaudited. The most recent period presented within the claims development tables is not considered required supplementary information, but it is subject to audit procedures.

If an insurance company prefers not to provide the requisite disclosures, the auditors could issue opinion modifications, assuming the company can secure appropriate regulator approval to omit the disclosures.

Act Now

Most private insurance companies will need to include the various new disclosures regarding claims development and average annual payout very soon. Thus far, public companies have presented 10 years' worth of data, with only the current year audited, all in the body of the footnotes. Private insurance companies can feel secure in following suit, but they should not underestimate the amount of time required to establish the necessary systems and processes and to compile the required information.



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