

17. (2.5 points)

Contrast the SAP and U.S. GAAP treatment for the following items:

- i. Discounting loss reserves
- ii. Ceded loss reserves for prospective reinsurance
- iii. Ceded loss reserves for retroactive reinsurance
- iv. Deferred acquisition costs
- v. Deferred tax assets

## SAMPLE ANSWERS AND EXAMINER'S REPORT

### Part a

Candidates were expected to describe the components required to estimate the fair value of insurance liabilities.

A common mistake was omitting one or more of the three components in their entirety.

### Part b

Candidates were expected to describe how to estimate each of the components underlying the estimate of fair value insurance liabilities.

A common mistake was omitting one or more of the three components in their entirety, or stating the components without explaining how each should be estimated.

### SPRING 2019 EXAM 6US, QUESTION 17

TOTAL POINT VALUE: 2.5

LEARNING OBJECTIVE: C3

#### SAMPLE ANSWERS

##### Sample responses for part (i)

- SAP: does not allow discounting except for special lines like workers compensation
- SAP: loss reserves generally cannot be discounted. Those lines that can, like workers compensation, use tabular discounts.
- SAP: does not allow discounting loss reserves
- GAAP: discounting of loss reserves is common
- GAAP: allows a more lax approach as long as the discount rate is reasonable and appropriate to the circumstances of settlement of claims
- GAAP: discount reserve
- SAP doesn't discount, GAAP does

##### Sample responses for part (ii)

- SAP: Directly net out from direct and assumed reserves in liabilities
- SAP: Can state net of reinsurance
- SAP: Loss reserves shown net of ceded loss
- GAAP: creates an asset to account for prospective reinsurance reserves
- GAAP: shows loss reserves gross of reinsurance and creates a reinsurance recoverable asset for ceded amounts
- GAAP: reserves are gross of reinsurance

##### Sample responses for part (iii)

- SAP: retro recoverables are recorded as a negative write in liability. Loss reserves are gross of all retro reinsurance.
- SAP: create a contra-liability for the reserves ceded. The surplus gain is added to other income, special surplus
- SAP: a negative write in liability
- GAAP: liability is gross of reinsurance reserves, ceded retro reinsurance reserves are recoverable in assets

## SAMPLE ANSWERS AND EXAMINER'S REPORT

- GAAP: the ceded loss reserves are treated as an asset
- GAAP: recognizes reserves gross of ceded reserves and establishes an asset for reserves recoverable.

### Sample responses for part (iv)

- SAP: Does not allow DAC
- SAP: incurred immediately (solvency view)
- SAP: does not exist, all expenses recognized immediately
- GAAP: allows acquisition costs to be deferred and recognized to be matched w/ revenue
- GAAP: creates a DAC asset which gets amortized over life of policy to better match revenue and expense
- GAAP: It is amortized across the policy period.

### Sample responses for part (v)

- SAP: there is a strict admissibility test for recognizing deferred tax assets and often they are excluded
- SAP: An asset is shown however there are more strict admissibility criteria in SAP
- SAP: subject to more strict admissibility test
- GAAP: fully allowed, but need to be checked regularly if they will be realized
- GAAP: DTAs always permitted for GAAP accounting
- GAAP: fully allowed
- Both allow for Deferred tax assets, but SAP has more stringent rules

### **EXAMINER'S REPORT**

Candidates were expected to demonstrate knowledge of the differences between SAP and US GAAP accounting for the treatment of 5 balance sheet items – some in terms of measurement and others in terms of presentation/placement.

Common mistakes were:

- Not stating the extent of possible loss reserve discounting for SAP. For example, under SAP only tabular discounting allowed.
- Not stating the creation of a SAP negative write-in liability for ceded retroactive reinsurance loss reserves. For example, SAP reserves are held gross of retroactive reinsurance.
- Not specifying if DTA is fully (GAAP) or partially (SAP) recognized. For example, DTA is an asset.