Federal Accounting Standards Advisory Board

April 11, 2014

Memorandum

To: Members of the Board

Robin M. Gilliam

From: Robin M. Gilliam, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subject: Risk Assumed – Insurance and Non-Loan Guarantee Phase – **Tab F**[1]

MEETING OBJECTIVE

I. Review revised definition

II. Discuss task force input regarding similarities to Credit Reform:

   A. What is similar to credit reform programs?

   B. What is different from credit reform programs?

BRIEFING MATERIALS

❒ Staff Memo - This memo provides the following:

I. Revised definition - *page 3*

II. Staff analysis on task force input on similarities to Credit Reform – *page 3*

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

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BACKGROUND

At the March 2014 meeting the Board reviewed the definition, characteristics and exclusions for the insurance and non-loan guarantee programs drafted by the task force. Mr. Dacey was concerned with the wording of the definition, in particular the placement of the word "risk" in the second sentence. The Board agreed to let staff work with Mr. Dacey to revise the definition and present it at the April 2014 meeting.

In addition, the Board generally agreed with the characteristics and exclusions with the understanding that as staff develops the standard and new information is discovered changes are possible and will be finalized within the standard.

MEMBER FEEDBACK

If you require additional information or wish to suggest another alternative not considered in the staff proposal, please contact staff as soon as possible. In most cases, staff would be able to respond to your request for information and prepare to discuss your suggestions with the Board, as needed, in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202-512-7356 or by e-mail at gilliamr@fasab.gov with a cc to paynew@fasab.gov.

[2] FY 2014 Budget Appendix: http://www.whitehouse.gov/omb/budget

I. Revised Definition:

A federal insurance/non-loan guarantee program is a program authorized by law to accept all or part of the risk by financially compensating the designated population for losses incurred as a result of an adverse event as defined by the:

A. law or otherwise enforceable by law,
B. related regulations,
C. agency policies, or
D. explicit arrangements or agreements

Does the Board Approve the Revised Definition?

II. Staff Analysis on Task Force Input Regarding Similarities to Credit Reform:

Staff continued to work with the task force to analyze Insurance and Non-Loan Guarantees (I/G) programs as compared to Loan Guarantee (LG) programs to determine conceptual similarities and differences. There were a number of similarities to credit reform programs but a larger number of differences. For a detailed analysis see *Attachment 1: Task Force Meeting Notes: March 20th and 27th, 2014, page 6.*

The most prominent difference is the uncertainty experienced by I/G programs to project expected losses and loss exposure. The higher uncertainty, as compared to LG programs is due to: the availability of data, contract duration, and adverse events.

One issue that contributes to uncertainty for I/G programs is the lack of available data. More specifically, I/G programs experience limited amounts of data and the data may not be available in a timely manner around the fiscal year boundaries, as compared to LG subsidy costs that are calculated and projected based on known face value loan amounts, amounts guaranteed, loan duration, and other factors affecting default. For new loan guarantee programs, estimation is more difficult in early years due to the lack of experience but quickly improves with experience.

Uncertainty is also impacted by contract duration, renewal and related expected premiums. For I/G programs that do issue contracts, most issue short term (1 year contracts). These I/G programs rely on the renewal of these contracts to fund prior and future losses, versus LG programs that provide long term contracts, such as guarantees of mortgages.

Adverse events also impact uncertainty for I/G programs depending on their innate characteristics. For I/G programs, will the adverse event be high impact yet low probability, hitting hard and instantaneous, approaching without warning and leaving devastating losses in its path? Or will an adverse event be more subtle like a long term draught that destroys crops outside of the fiscal year boundary, because Mother Nature has her own time frame? I/G programs are challenged with projecting losses as they too ask themselves these questions making actuarial modeling difficult, if not impossible. On the other hand, an adverse event for LG is always the inability to pay a debt obligation.

In summary, due to the lack of available data in a timely manner, contract duration and the innate characteristics of adverse events, insurance and non-loan guarantee programs experience greater uncertainty, as compared to loan guarantee programs, in projecting expected losses and loss exposure. Nonetheless, the President's Budget provides budget information for ten years for most insurance programs. Also, a small number of programs are currently projecting future cash flows for planning or rate setting purposes. However, there are varying degrees of uncertainty among I/G programs and we continue to explore the methods used to provide budget projections as well as longer-term estimates.

Table 1: Excerpt from President's Budget (FY2015) regarding Terrorism Risk Insurance
The Budget baseline includes the estimated Federal cost of providing terrorism risk insurance through the expiration of the program on December 31, 2014. Using market data synthesized through a proprietary model, the Budget projects annual outlays and recoupment for TRIP. While the Budget does not forecast any specific triggering events, the estimates for this account represent the weighted average of TRIP payments over a full range of possible scenarios, most of which include no notional terrorist attacks (and therefore no TRIP payments), and some of which include notional terrorist attacks of varying magnitudes. On this basis, the Budget projects net spending of $230 million over the 2015-2019 period and $300 million over the 2015-2024 period. In order to preserve the long-term availability and affordability of property and casualty insurance for terrorism risk, the Budget proposes to extend the Terrorism Risk Insurance Program and to implement programmatic reforms to limit taxpayer exposure and achieve cost neutrality. The Administration will work with Congress to identify appropriate adjustments to program terms to achieve budget neutrality and, over the longer term, full transition of the program to the private sector. Building on previously enacted reforms to the program, this extension may include changes to the size of the deductible, the threshold for a certified terrorist event, or the loss-sharing percentages for the Government and covered firms after the deductible is exceeded.

- **What thoughts does the Board have about the task force findings on the similarities and differences to credit reform programs?**
- **Would the Board like any additional analysis on this topic?**

III. NEXT STEPS:

For the next steps, staff would like to determine:

1. At what point (or points) is the liability definition met? There might be different points in time for different types or classes of insurance.
2. When the liability definition is met, what is the best measure of the liability?
3. Under what circumstances, would this best measure be considered measurable and be recognized?
4. When the best measure is not recognized due to measurability concerns, what should be recognized?
5. What should be disclosed [(that is, what disclosures result from applying the draft risk disclosure framework (note the draft was presented in December 2013)]?

Does the Board agree with the Next Steps?

IV. Questions/Discussion for the Board:

1. Does the Board Approve the Revised Definition?
2. What thoughts does the Board have about the task force findings on the similarities and differences to Credit Reform Programs?
3. Would the Board like any additional analysis on this topic?
4. Does the Board agree with the Next Steps?

TAB F

– Attachment 1 –

Task Force Meeting Notes:

March 20th and 27th, 2014

A. What is similar to Credit Reform Programs?[3]

Both Loan Guarantee (LG) and Insurance/Non-Loan Guarantee (I/G) programs:

i. Are driven by a policy purpose (mission)
ii. Use the term "insurance"
iii. Provide financial compensation
iv. Are impacted by an adverse event
v. Protect against risk of loss
vi. Receive funding - collect fees/premiums
vii. Incur administrative costs
viii. Face uncertainty in projecting expected loss exposure
ix. Experience financial risk
x. Maintain "reserves"
xi. Have specific arrangements/agreements (contracts)
xii. Recover funding through acquired assets
xiii. Accept all or part of risk
xiv. Hierarchy of Authority

B. What is different from Credit Reform Programs?

i. PURPOSE:

- LG:
  - Provides a means of financing a particular activity to enable businesses access to credit to stimulate the economy or environment, for example to develop renewable energy or a new technology.

[3] For the purposes of this document, when referring to credit reform programs, staff will reference loans (debt obligations) by non-federal lenders (lender) to non-federal borrowers (borrower). However, OMB has advised the task force that they must scrutinize the economic substance for each program to fully understand whether there are underlying debt obligations, such as in the example of mortgaged backed securities which are "insured."

- I/G:
  - Provides insurance or a non-loan guarantee for losses sustained as a result of an adverse event to avoid a negative economic or environmental impact which may also stimulate the economy.

ii. INSURANCE:

- LG:
  - The term “insurance” is often used in the description of credit reform programs because the function of the program is a pledge of insurance or a guarantee of a debt obligation, but they operate as and are treated as loan guarantees for:
    - Non federal lenders (lenders)
    - Non federal borrowers (borrowers)
- I/G:
  - The term “insurance” is often included in the program’s title[4] and provides for losses incurred as a result of an adverse event not related to the default of a debt obligation.

iii. FINANCIAL COMPENSATION:

- LG:
  - Provides financial compensation to lenders for a defaulted debt obligation, where the contracting agency “buys” the loan from the lender per the terms of the contract.
- I/G:
  - Provides financial compensation to the designated population for all or part of losses sustained from an adverse event.

iv. ADVERSE EVENT

- LG:
  - An adverse event is the inability to pay a debt obligation.[5]
- I/G:
  - An adverse event triggers losses for a designated population.

[4] See Appendix II – List To Date of Identified Insurance/Non-Loan Guarantee Programs.
[5] For example, this is usually when a non-federal borrower defaults on a loan by a non-federal lender.

v. RISK OF LOSS:

- LG:
    - Protects lender from risk of loss equal to the “insured” portion of the defaulted debt obligation.
- I/G:
    - Protects designated population from all of part of the risk of loss resulting from an adverse event.

vi. FUNDING - FEES/PREMIUMS:

- LG:
    - Nets fees/premiums against outlays to calculate subsidy costs for budgetary and financial reporting.
    - May not label them as “premiums.”
    - Minimal volatility of premiums due to long-term contracts.

- I/G:
    - Do not net fees/premiums against outlays for budgetary reporting.
    - May rely on renewal of short term contracts to provide necessary funding for prior year losses.
    - May be adjusted according to projections and prior year losses (that is, some programs are required to break even or establish minimum reserves over time).
    - May be capped as dictated by statutory authority (FAA- Aviation Insurance).
    - Volatility of Premiums:
        - Minimal volatility with long term contracts
            - OPIC = 20 year contracts
        - More volatility with short term (1 year) contracts:
            - Expect a long-term relationship for continued renewals
            - Economic incentives offered or statutory requirement for renewal to guarantee continued funding from premiums/fees
                - NFIP – 1 year; 90% renewal rate
                    - Property owners can:
                        - Purchase or
                        - May be required if in a flood zone
                - Aviation Insurance (FAA) – only carrier that offers this type of war-time insurance.

vii. ADMINISTRATIVE COSTS for BUDGETARY REPORTING PURPOSES:

- LG:
  - The Federal Credit Reform Act requires that administrative costs NOT be included in the calculation of subsidy costs whereas such costs are actually maintained in a separate sub-budgetary account.[6]
- I/G:
  - This law does not apply to insurance and non-loan guarantee programs and we have not reviewed the structure of budgetary accounts to identify current practices.

viii. UNCERTAINTY – PROJECTING EXPECTED LOSS EXPOSURE:

The ability to project expected losses depends on the amount (volume) and availability of data.

- LG:
  - Are able to project expected losses with greater confidence and less uncertainty because they know the:
    - Face value of the loans guaranteed
    - Length of loans
    - History of similar loans
    - High volume of participants which improves estimates

  - Factors that reduce confidence and increase uncertainty include:
    - Loan PREpayments which are more difficult to project and they affect expected fee income which drives pricing decisions
    - Lack of history for new markets
- I/G:
  - Cannot project expected losses with confidence for:
    - A high impact/low probability events:
      - FAA – Aviation Insurance: Adverse event = nuclear bomb at an airport:
        - Projecting this loss is very difficult for FAA since:
          - Not every airline flies into every airport.
          - FAA has analyzed the 10 busiest airports and what airlines service them, but that is as far as they could take the analysis.
      - OPIC - Adverse event = Political Violence:
        - Cannot predict emergence of a dictator or a takeover by a neighboring country.
      - FEMA – Flood Insurance: Adverse event: catastrophic flood.

[6] Federal Credit Reform Act, SEC 504(g): all funding for an agency's administration of a direct loan or loan guarantee program shall be displayed as distinct and separately identified subaccounts within the same budget account as the program's cost.

        - Cannot predict when a Katrina or Sandy will occur or the impact of loss.

- <u>Cyclical/reoccurring events:</u>
  - Crop Insurance (AG-RMA), hard to estimate even short term losses because of timing and amount of available data:
    - Revenue is based on the yield and commodity prices that may not have occurred by the end of the fiscal year.
      - If by the end of the fiscal year the commodity price has not been released this could trigger a loss.
    - Mother Nature does not follow the fiscal year:
      - Crops are not harvested at the end of the fiscal year.
      - Therefore they predict loss based on historical trends, but each year is different.

ix. <u>FINANCIAL RISK</u>:

- LG:
  - Have a good estimate of the default payment.
  - Full faith and credit of the federal government to pay loan guarantees.
- I/G
  - Do not know the full impact until claims are received and processed.
  - Most have borrowing authority:[7]
    - OPIC
    - Crop
    - Flood
  - Some, but not all, have the full faith and credit of the federal government.
    - PBGC does NOT have full faith and credit.[8]

[7] By statute, an agency may have authority to borrow from the Treasury up to a certain level once other sources of funding have been exhausted, for example: 1) Crop Insurance legislation states that they will receive "such sums as necessary." For years that Crop Insurance has expected losses they have to justify their request to OMB, and will then receive an appropriation, but at the end of the fiscal year must return anything not used; and 2) OPIC must use their reserves first, but once those are exhausted have $100 million in indefinite borrowing authority.

[8] PBGC obligations are not backed by the full faith and credit of the US Government. ERISA section 4001(g)(2) states the following with respect to the federal government responsibilities to PBGC's obligations: "The receipts and disbursements of the corporation in the discharge of its functions shall be included in the totals of the budget of the United States Government. The United States is not liable for any obligation or liability incurred by the corporation."

x. <u>MAINTAIN "RESERVES:"</u>

- LG:
    - Sets aside funds in the financing account to cover cash flow needs.
    - Adjusts upon reestimate of subsidy costs.
- I/G:
    - Some programs maintain reserves per statutory authority related to program specifics:
        - FCSIC[9]

<u>CONTRACTS:</u>

- LG:
    - There is always a contractual agreement to provide a loan guarantee.
    - Contracts are long term
- I/G:
    - Contracts are not required for all I/G programs
        - Some I/G have specific arrangements per statute and others may have agreements (contracts).

[9] Farm Credit Service Insurance Corporation (FCSIS) by statute must maintain a 2% Secure Base Amount of adjusted insured debt outstanding: 2012 Annual Report, http://www.fcsic.gov/FCSIC%20Annual%20Reports.html

TAB F – Appendices

(Optional Reading for Reference)

Risk Assumed: Insurance and Non-Loan Guarantees

TAB F - Appendix 1:
Risk Assumed - Project Decision History

March 2014:

The Board generally agreed with the insurance/non-loan guarantee definition, upon updates from Mr. Dacey, as well as the characteristics and exclusions presented in the staff memo with the understanding that as staff develops the standard and new information is discovered changes are possible and will be finalized within the standard.

Staff worked with Mr. Dacey to update some of his concerns with the definition.

The following is the revised definition:

> A federal insurance/non-loan guarantee program is a program authorized by law to accept all or part of the risk by financially compensating the designated population for losses incurred as a result of an adverse event as defined by the:
>
> A. law or otherwise enforceable by law,
>
> B. related regulations,
>
> C. agency policies, or
>
> D. explicit arrangements or agreements

December 2013:

1. The Board agreed with staff's recommendation that it would be difficult to apply the FASB proposed insurance contracts definition to federal insurance/guarantee programs
    - Board requested and Staff agreed to present FASB's proposed definition to the Task Force during the development of the federal definition

2. The Board agreed with Staff's next step to develop a general definition and specific characteristics of insurance and guarantee programs.

<u>June 2013:</u>

1. The Board agreed with staff's recommendation to ask the four federal entities identified to respond to specific questions on FASB's insurance contracts proposal. Staff would use those responses to identify application concerns that would be unique to a federal entity.

2. The Board agreed to further narrow the scope to federal insurance and guarantee **programs** rather than contracts to support the structure of the federal environment and president's budget.

<u>February 2013</u>:

The risk assumed project will be addressed in a **phased approach**:

- <u>Phase I:</u> Insurance and Guarantees
- <u>Phase II:</u> Entitlement Programs, including: national defense, security and disaster response; and other potential effects on future outflows, such as regulatory actions, GSE's, etc.
- <u>Phase III</u>: Commitments and Obligations and other risk areas

TAB F – Appendix 2:

List to Date of Identified Insurance/Non-Loan Guarantee Programs

#	Agency	Insurance/ Non-Loan Guarantee Program	Description *[Sources may include 2013 Budget Appendix and/or Program Annual Reports and/or Websites]*
1	DOD	War Risk (Marine) Insurance	Providing premium third party liability war risk insurance. Covers: hull losses; death, injury or property loss to passengers, or crew resulting from an act of war.
2	FAA/DOD	War Risk (Airline) Insurance	
3	FCSIC	Farm Credit System Insurance Corporation	Protecting Investors in agriculture and rural America. Insures the timely payment of principal and interest on certain System notes, bonds, and other obligations issued to investors.
4	FDIC	Federal Deposit Insurance Corp	To maintain stability and public confidence in the nation's financial system by insuring deposits, examining and supervising financial institutions for safety and soundness and consumer protection, and managing receiverships.
5	FEMA	National Flood Insurance Program	To help provide a means for property owners to financially protect themselves. Offering flood insurance to homeowners, renters, and business owners if their community participates in the NFIP.
6	HHS	Early Retiree Reinsurance Program (Scheduled to end in 2014)	Provides reimbursement to participating sponsors of certified plans that provide health benefits to early retirees (age 55 and older and not eligible for Medicaid) their spouses and surviving spouses and dependents. Affordable Care Act (ACA)
7	HHS	Pre-Existing Condition Insurance Plan Program (PCIP) (Scheduled to end in 2014)	Offers the option of two additional months of PCIP coverage to people currently enrolled in PCIP who have not yet found new health insurance coverage. This transitional coverage through March 31, 2014, will allow PCIP enrollees more time to review (ACA) Marketplace plan options and enroll in the coverage that best meets their needs before open enrollment closes in March.
8	HHS/HRSA	National Vaccine Injury Compensation Program	To ensure an adequate supply of vaccines, stabilize vaccine costs, and establish and maintain an accessible and efficient forum for individuals found to be injured by certain vaccines. The VICP is a no-fault alternative to the traditional tort system for resolving vaccine injury claims that provides compensation to people found to be injured by certain vaccines.
9	NCUA	Credit Union Share Insurance Fund	To facilitate the availability of credit union services to all eligible consumers, especially those of modest means, through an objective independent regulatory environment that protects credit union members.
10	NRC	Price Anderson - Nuclear Power Plants catastrophe	to ensure that adequate funds would be available to satisfy liability claims of members of the public for personal injury and property damage in the event of a nuclear accident involving a commercial nuclear power plant.

#	Agency	Insurance/ Non-Loan Guarantee Program	Description *[Sources may include 2013 Budget Appendix and/or Program Annual Reports and/or Websites]*
11	OPIC	Overseas Private Investment Corporation	Allows U.S. businesses to take advantage of commercially attractive opportunities in emerging markets, mitigating risk and helping them compete in a global marketplace...Provides innovative, comprehensive, and cost-effective risk-mitigation products to cover losses to tangible assets, investment value, and earnings that result from political perils.
12	OPM	Federal Employees Life Insurance (FEGLI)	A life insurance program for Federal and Postal employees and annuitants,
13	PBGC	Pension Benefit Guarantee Corporation	Protects the retirement incomes of more than 40 million American workers in more than 26,000 private-sector defined benefit pension plans… created to encourage the continuation and maintenance of private-sector defined benefit pension plans, provide timely and uninterrupted payment of pension benefits, and keep pension insurance premiums at a minimum.
14	TREASURY	Check Forgery Insurance Fund	Facilitates timely payments for replacement Treasury checks necessitated due to a claim of forgery. To reduce hardships sustained by payees of government checks that have been stolen and forged, settlement is made in advance of the receipt of funds from the endorsers of the checks.
15	TREASURY	Terrorism Insurance Program	Provides for a transparent system of shared public and private compensation for certain insured losses resulting from a certified act of terror.
16	USDA	Federal Crop Insurance Corporation (FCIC)	To provide for nationwide expansion of a comprehensive crop insurance plan...includes products involving yield and revenue insurance, pasture, rangeland and forage, livestock, and other educational and risk
17	VA	National Service Life Insurance Fund	For World War II era Veterans
18	VA	Service-disabled Veterans Insurance Fund (SDVIF)	For Veterans separated on or after Apr. 25, 1951 who receive a service-connected disability rating
19	VA	Service members' Group Life Insurance Fund (SGLI)	For members of the Uniformed Services on active duty and Ready reservists
20	VA	United States Government Life Insurance (USGLI)	For Veterans who served in World War I and through October 8, 1940
21	VA	Veterans' Special Life Insurance (VSLI)	For Korean War era Veterans separated from service without a service-connected disability
22	VA	Veterans' Reopened Life Insurance (VRI)	For World War II and Korean War Veterans with service-connected or serious non-service-connected
23	VA	Veterans' Mortgage Life Insurance (VMLI)	For severely disabled Veterans who have received specially adapted housing grants.
24	VA	Veterans' Group Life Insurance (VGLI)	For Veterans and separated or retired Reservists who had SGLI while in service
25	VA	Family Service members' Group Life Insurance (FSGLI)	For spouses and children of members insured under the SGLI program.
26	VA	Service members' Group Life Insurance Traumatic Injury Protection (TSGLI)	Automatic coverage for all SGLI insureds that provides for insurance payments to members who suffer a serious traumatic injury while in service

TAB F – Appendix 3:

List to Date of Programs Named as "Insurance" But NOT Identified as Insurance and Non-Loan Guarantee Programs

Program Name (from 2014 Budget Appendix)	**Agency**
State Unemployment <u>Insurance</u> and Employment Service Operations	DOL
State Unemployment <u>Insurance</u> and Employment Service Operations	DOL LABOR
Payment Where Small Business Health <u>Insurance</u> Tax Credit Exceeds Liability for Tax	TREASURY-IRS
Administrative Expenses, Railroad Unemployment <u>Insurance</u> Extended Benefit Payments	Railroad Retirement Board
Railroad Unemployment <u>Insurance</u> Extended Benefit Payments, Recovery Act	Railroad Retirement Board
Federal Disability <u>Insurance</u> Trust Fund	SSA
Federal Old-age and Survivors <u>Insurance</u> Trust Fund	SSA
Administrative Expenses, Children's Health <u>Insurance</u> Program	SSA
Federal Old-age and Survivors <u>Insurance</u> Trust Fund	SSA
Health <u>Insurance</u> Tax Credit Administration	TREASURY
Children's Health <u>Insurance</u> Fund (CHIP)	HHS
HHS: Early Retiree Rei<u>nsurance</u> Program	HHS
Federal Hospital <u>Insurance</u> Trust Fund	HHS
Federal Supplementary Medical <u>Insurance</u> Trust Fund	HHS
Affordable <u>Insurance</u> Exchange Grants	HHS
Health <u>Insurance</u> Reform Implementation Fund	HHS
Insurance Trust Fund	HHS
Pre-Existing Condition <u>Insurance</u> Plan Program	HHS
Affordable <u>Insurance</u> Exchange Grants	HHS/CMM