



December 6, 2013

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 Guarantee Phase – **Tab F**¹

MEETING OBJECTIVES

To review the impact of the FASB Exposure Draft, Proposed Accounting Standards Update, Insurance Contracts (Topic 834) Issued June 27, 2013, on four federal insurance/guarantee entities that primarily apply Financial Accounting Standards Board standards (hereafter 'FASB GAAP') and their views on the applicability of this proposed standard. From the staff's research we will explore whether the "insurance contract" definition is suitable for federal insurance programs.

We will also review next steps identified from the June 2013 Board meeting to determine how to proceed.

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.

BRIEFING MATERIAL

- ☐ Staff Memo - Staff Analysis and Board Questions – Risk Assumed: Insurance and Guarantee Phase
- ☐ Attachments
 1. FASB Slide deck –Insurance Contracts: Summary of project and proposed Update²
 2. FASAB October 18, 2013, query letter and attachments sent to federal insurance/guarantee entities following FASB GAAP to determine the potential impact of FASB's insurance contracts standards June 27, 2013, exposure draft.
 3. November 19, 2013, FASAB - PBGC meeting notes
 4. December 03, 2013, FASB News: Insurers, Analysts Take Cautious Stance on Insurance Proposal
- ☐ Appendices (Optional Reading for Reference)
 1. Risk Assumed - Project Decision History
 2. Federal Insurance Summary Factsheets for entities interviewed by FASAB
 3. Fiscal Exposures – Improving Cost Recognition in the Federal Budget - GAO Highlights GAO 14-28, October 2013

BACKGROUND

The risk assumed project is taking a broad look at all types of transactions and events that may result in future outflows as a result of the federal government's mission, operations, and current or past actions. During the summer of 2012 staff held two task force meetings on two explicit groupings of risk assumed: (1) commitments and obligations, including contracts, grants, and treaties, and (2) insurance and guarantees.

As a result of those meetings and related research, staff recommended and the Board approved the following **three-phased approach**:

Phase I: Insurance and Guarantees

Phase II: Entitlement Programs, including: national defense, security and disaster response; and other potential effects on future outflows, such as regulatory actions, GSE's, etc.

Phase III: Commitments and Obligations and other risk areas

² This is a FASB summary slide deck from a podcast in support of their June 27, 2013, Topic 834 release; it is not the same slide deck presented by Jennifer Weiner at the FASAB April 2013 Board meeting.

Insurance and Guarantees - Phase I:

- During the April 2013 meeting, Jennifer Weiner from FASB delivered an educational session on the FASB proposed insurance contracts standard (Topic 834).
- The June 2013 meeting material provided summary factsheets on several programs to gain a better understanding of the types of federal insurance programs.

In developing **the scope** at the June 2013 meeting, it was determined that the next steps for the Insurance and Guarantees Phase are as follows:

- Develop a general definition and specific characteristics of insurance and guarantees
- Evaluate the similarities and differences between loan guarantees and federal insurance and non-loan guarantees.
 - Get a clearer understanding of the credit reform standards and how that approach could assist in considering revisions to our current insurance and guarantee standards.
- Evaluate the potential impact of the new FASB insurance contracts proposed standard on those federal entities that follow FASB GAAP
 - Consider ways to evaluate the potential impact of the new FASB insurance contracts proposed standard on those federal entities that follow FASB GAAP.
 - In addition, while the individual entities apply FASB, FASAB will wish to consider any effect on the government-wide report. For example, whether concerns regarding comparability arise and whether additional disclosures or RSI would be needed upon consolidation.
- Develop a framework for use in later phases.

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.

Staff Analysis and Questions for Board Consideration on the FASAB Risk Assumed Project: Insurance and Guarantee Phase

One of the next steps identified at the June 2013 Board meeting was to evaluate the potential impact of the new FASB insurance contracts proposed standard on those federal entities that follow FASB GAAP in order to consider whether :

- FASB’s definition of “insurance contracts” can be used in FASAB’s development of a general definition and specific characteristics of federal insurance and non-loan guarantees?
- There will be any effect on the government-wide report in relation to consistency and comparability and whether additional disclosures or RSI would be needed upon consolidation.

Staff researched and/or interviewed four federal insurance/guarantee entities identified as FASB GAAP reporters. Staff will review the impact of the FASB Exposure Draft, Proposed Accounting Standards Update, Insurance Contracts (Topic 834) Issued June 27, 2013, on four federal insurance/guarantee entities and their views on the applicability of this proposed standard.

The four federal insurance/guarantee FASB GAAP reporting entities are:

- Federal Deposit Insurance Corporation (FDIC)
- Pension Benefit Guarantee Corporation (PBGC)
- Farm Credit System Insurance Corporation (FCSIC)
- Overseas Private Investment Corporation (OPIC)

Questions Asked of the Four Federal Agencies following FASB GAAP:

1. Do you currently follow FASB's Accounting Standards Codification (ASC) 944, Financial Services – Insurance, or FASB ASC 450, Contingencies?
2. Do you believe any programs within your entity would meet FASB's definition of an insurance contract and therefore be within the scope of the FASB Insurance Contracts proposal? If so, why? If not, why not?

Definition of an Insurance Contract:

834-10-55-1 An **insurance contract** is a contract under which one party (the issuing entity) accepts significant³ **insurance risk**⁴ from another party (the policyholder) by agreeing to compensate the **policyholder**⁵ or its designated beneficiary if a specified uncertain future event (the **insured event**)⁶ adversely affects the policyholder.⁷

3. Do you believe that your entity's insurance product(s) has characteristics that align with either the FASB's proposed premium allocation approach (PAA) or building block approach (BBA)? Please elaborate on your response.
4. What benefits or drawbacks do you see in applying the PAA and/or the BBA measurement approach?
5. Do you have any additional comments on the recognition of your entity's insurance activities that would benefit FASAB in developing the federal GAAP for risk associated with insurance?
6. If you are currently reporting under FASB 5 (ASC 450) for Contingent Liabilities, would you consider switching to FASB's proposed Update for Insurance Contracts? Why, Why not?

³FASB Exposure Draft (ED), Proposed Accounting Standards Update, Issued: June 27, 2013, page of 66, **834-10-55-9: Insurance risk** is considered **significant** if, and only if, an insured event exposes an entity to a significant loss. Existence of one scenario in which the present value of the cash flows expected to be paid by the entity can significantly exceed the present value of the premiums and other cash inflows will be considered to satisfy the existence of significant insurance risk.

⁴ FASB ED, page 29, Glossary: **Insurance Risk** - The risk arising from uncertainties about underwriting risk as opposed to financial risk. Insurance risk is fortuitous; the possibility of adverse events occurring is outside the control of the insured. Page 34, Glossary, **Underwriting Risk** - The risk arising from uncertainties about the amount of net cash flows from premiums, commissions, claims, and claim settlement expenses paid under a contract.

⁵ FASB ED, page of 31, Glossary: **Policyholder** - A party that has a right to compensation under an insurance contract if an insured event occurs. The policyholder may elect that a beneficiary receive claim or benefit payments under the contract.

⁶ FASB ED, page of 29 Glossary: **Insurance Event** - An uncertain future event that is covered by an insurance contract and creates insurance risk.

⁷ FASB ED, page 64.

NOTE: the information presented below is the view of the federal insurance FASB reporters or their auditors. Staff has not itself reached a conclusion regarding the proper application of the proposed standards by these entities. Thus, staff is only reporting on the information gathered.

Answers to Interview Questions:

1. Do you currently follow FASB's Accounting Standards Codification (ASC) 944, Financial Services – Insurance, or FASB ASC 450, Contingencies?	
Federal FASB GAAP Entities	Answers
FDIC	FDIC follows ASC 450, Contingencies
PBGC ⁸	PBGC follows ASC 960, Plan Accounting – Defined Benefit Pension Plans, not Topic 944, Insurance Contracts. However, for contingent liabilities, in accordance with the FASB Accounting Standards Codification Section 450, Contingencies , PBGC recognizes net claims for probable terminations which represent PBGC's best estimate of the losses, net of plan assets, and the present value of expected recoveries (from sponsors and members of their controlled group) for plans that are likely to terminate in the future.
FCSIC	FCSIC follows Codification Section 944, Financial Services - Insurance in determining what its obligations would be in the event of a triggering event. Because it has not been probable that certain losses would occur, FCSIC has not booked any liabilities related to insurance losses.
OPIC	OPIC follows ASC 450, Contingencies

25% of federal FASB reporters interviewed follow ASC 944, Financial Services—Insurance.

75% of federal FASB reporters interviewed follow ASC 450, Contingencies.⁹

⁸ Answers from PBGC's 10/30/13 response letter, **bolded** text is for emphasis.

⁹ PBGC changes their liability reporting from ASC 450, Contingencies to ASC 960, Plan Accounting – Defined Benefit Pension Plans, once a plan actually terminates.

2. Do you believe any programs within your entity would meet FASB's definition of an insurance contract ¹⁰ and therefore be within the scope of the FASB Insurance Contracts proposal? If so, why? If not, why not?	
Federal FASB GAAP Entities	Answers
FDIC	<p>GAO auditors do not think that FDIC's program meets FASB's definition due to FDIC's definition of their service:</p> <p>The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress to maintain stability and public confidence in the nation's financial system by:</p> <ul style="list-style-type: none"> • insuring deposits, • examining and supervising financial institutions for safety and soundness and consumer protection, and • managing receiverships.¹¹
PBGC	<p>As stated in FASB Topic/section 834-10-15-5 subsection b, the Exposure Draft scopes out certain types of contracts, such as an employer's assets and liabilities under employee benefit plans (see Topic 715 retirement benefits) and retirement benefit obligations reported by defined benefit retirement plans (see Topic 960 on defined benefit pension plans), which PBGC administers. PBGC properly values, accounts and discloses its financial assets and liabilities consistent with ASC 960, Plan Accounting – Defined Benefit Pension Plans. For this reason, we believe that PBGC is scoped out of the implementation of the Exposure Draft on Insurance Contracts (Topic 834) as it is currently written.</p>
FCSIC	<p>No, FCSIC does not think [emphasis added] that they meet the FASB proposed definition of an insurance contract for the following reasons which were provided by their auditor:</p> <ul style="list-style-type: none"> ○ While there are contracts pursuant to ASC 944, they do not appear to meet the FASB's "significant insurance risk"¹² criteria for the insurance contract changes to apply. ○ There are very few, if any losses, and thus it doesn't appear this requirement is met, qualitatively or quantitatively. <p>And, therefore, the ED would not apply to them.</p>
OPIC	<p>Yes, the Political Risk Insurance meets the definition of FASB's proposed insurance contract definition. It would fall under the Premium Allocation Approach.</p>

¹⁰ See page 5 above for definition.

¹¹ FDIC's mission statement as copied from their website: <http://www.fdic.gov/about/mission/>.

¹² FASB ED, page of 66, **834-10-55-9: Insurance risk** is considered **significant** if, and only if, an insured event exposes an entity to a significant loss. Existence of one scenario in which the present value of the cash flows expected to be paid by the entity can significantly exceed the present value of the premiums and other cash inflow will be considered to satisfy the existence of significant insurance risk.

25% of federal FASB reporters interviewed believe their product **meets** FASB's proposed definition of an insurance contract.

75% of federal FASB reporters interviewed believe their product **does NOT meet** FASB's proposed definition of an insurance contract.

3. Do you believe that your entity's insurance product(s) has characteristics that align with either the FASB's proposed premium allocation approach (PAA) or building block approach (BBA)? Please elaborate on your response.

Federal FASB GAAP Entities	Answers
FDIC	Not Applicable re answer to Q2
PBGC	<p>In addition to the fact pointed out in our response for question 2 (because PBGC uses ASC 960, our accounting is scoped out of the FASB Insurance Contracts proposal), we also believe that our accounting does not align with PAA or BAA. ERISA¹³ mandates that the value of a terminated pension plan's benefit liabilities be determined "on the basis of assumptions prescribed by PBGC", rather than the FASB's proposed approaches as described above. Consequently, when Congress directed in 1987 that a pension plan's benefit liabilities should be determined "on the basis of assumptions prescribed by PBGC," it ratified the existing PBGC valuation regulation which prescribes such assumptions. As the court in the US Airways bankruptcy case found in upholding the PBGC valuation regulation, "That regulation was already in effect when the statute was amended to its present form, and the court must therefore presume that Congress knew and approved of the PBGC's general methodology."</p> <p>No for the PAA model. ERISA prescribes an annual premium. However, ERISA requires PBGC to guarantee the defined benefit plan regardless of payment for an indefinite period prescribed by ERISA. PBGC does not have sufficient data to reasonably estimate or predict future terminations for accounting purposes, so PBGC cannot recognize or disclose a loss at contract inception.</p> <p>No, for the BBA model. PBGC's valuation model is unique pursuant to ERISA Title IV guarantee. The premiums are not negotiated under a contractual</p>

¹³ Employee Retirement Income Security Act (ERISA). The Employee Retirement Income Security Act of 1974 (ERISA) is a federal law that sets minimum standards for pension plans in private industry. ERISA does not require any employer to establish a pension plan. It only requires that those who establish plans must meet certain minimum standards. The law generally does not specify how much money a participant must be paid as a benefit. ERISA requires plans to regularly provide participants with information about the plan including information about plan features and funding; sets minimum standards for participation, vesting, benefit accrual and funding; requires accountability of plan fiduciaries; and gives participants the right to sue for benefits and breaches of fiduciary duty.

ERISA also guarantees payment of certain benefits through the Pension Benefit Guaranty Corporation, a federally chartered corporation, if a defined plan is terminated.

The Department of Labor's (DOL) Employee Benefits Security Administration (EBSA) enforces ERISA.
<http://www.dol.gov/compliance/laws/comp-erisa.htm>

3. Do you believe that <u>your entity's insurance product(s) has characteristics that align with either the FASB's proposed premium allocation approach (PAA) or building block approach (BBA)? Please elaborate on your response.</u>	
Federal FASB GAAP Entities	Answers
	<p><i>(continued from page 9)</i> arrangement, but are provided for under Title IV of ERISA. PBGC does not have sufficient data to calculate with any reasonable certainty cash flows from continuing plans and underfunded liabilities for future terminations to follow the BBA model.</p> <p>PBGC values its financial assets and investments at estimated fair value, consistent with the standards for pension plans contained in the FASB Accounting Standards Codification Section 960, Defined Benefit Pension Plans. PBGC values its liabilities for the present value of future benefits and present value of nonrecoverable future financial assistance using assumptions derived from market-based annuity prices from insurance companies, as described in PBGC's Statement of Actuarial Opinion. As provided in ASC 960, the assumptions are "those assumptions that are inherent in the estimated cost at the (valuation) date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits." Also, in accordance with ASC 960, PBGC selects assumptions for expected retirement ages and the cost of administrative expenses in accordance with its best estimate of anticipated experience.</p>
FCSIC	Not Applicable re answer to Q2
OPIC	<p>Yes, the Political Risk Insurance aligns with the PAA, since it is not life or annuity. It provides property liability and casualty for a term period, about a year, but can be longer. OPIC has the option not to renew. As the insurance term gets close to expiring, OPIC sends an election of coverage to the policyholder. OPIC offers the policyholder three types of political risk insurance. The policy holder can choose one, two or all three of the following:</p> <ol style="list-style-type: none"> 1. Inconvertibility of currency 2. Expropriation 3. Political violence

25% of federal FASB reporters interviewed believe their insurance product **has characteristics** that align FASB's proposed premium allocation approach (PAA).

75% of federal FASB reporters interviewed believe that their insurance product **does NOT** have characteristics that align with FASB's proposed premium allocation approach (PAA).

100% of federal FASB reporters interviewed believe that their insurance product **does NOT** have characteristics that align with FASB's proposed building block approach (BBA).

4. What <u>benefits or drawbacks</u> do you see in applying the PAA and/or the BBA measurement approach?	
Federal FASB GAAP Entities	Answers
FDIC	Not Applicable re answer to Q3
PBGC	Neither approach fits PBGC's hybrid business operation as described above.
FCSIC	Not Applicable re answer to Q3
OPIC	<p>At this time OPIC is not sure of the benefits or drawbacks. There is a lot of research that they need to conduct before they can determine what benefits or drawbacks would impact OPIC.</p> <p>OPIC did mention that the FASB proposed insurance contracts standard appeared to be moving in the direction of the Credit Reform Act.</p>

100% of federal FASB reporters interviewed **did NOT offer** any benefits or drawbacks to applying the PAA or BBA measurement approach.

5. Do you have any <u>additional comments on the recognition of your entity's insurance activities</u> that would benefit FASAB in developing the federal GAAP for risk associated with insurance?	
Federal FASB GAAP Entities	Answers
FDIC	Nothing additional to add at this point ¹⁴
PBGC	Not at this time. No. FASB's proposed Update for Insurance Contracts is not compatible with PBGC's financial reporting as described in our response for Q4.
FCSIC	Nothing at this moment but will send along as I (FCSIC Auditor) see / think of it.
OPIC	<p>OPIC Political Risk Insurance:</p> <ul style="list-style-type: none"> • Claims are low frequency, yet high impact • Is self sustaining through premiums collected by investors to support claims • Is very unique since the events are triggered by foreign country behavior that is difficult to actuarially model. • OPIC Financial Statement Note 9: Under most OPIC insurance contracts, investors may obtain all three coverages, but claim payments may not exceed the single highest coverage amount. Claim payments are limited by the value of the investment and the amount of current coverage in force at the time of the loss and may be reduced by the insured's recoveries from other sources. In addition, in certain contracts, OPIC's requirement to pay up to the single highest coverage amount is further reduced by stop-loss and risk-sharing agreements. Finally, losses on insurance claims may be reduced by recoveries by OPIC as subrogee of the insured's claim against the host government. Payments made under insurance contracts that result in recoverable assets are reported as assets acquired in insurance settlements. <p>OPIC did mention that the proposed FASB proposed insurance contracts standard appeared to be moving in the direction of the Credit Reform Act.</p>

25% of federal FASB reporters interviewed **offered additional comments** that would benefit FASAB in developing the federal GAAP for risk associated with insurance.

75% of federal FASB reporters interviewed **did NOT** offer additional comments that would benefit FASAB in developing the federal GAAP for risk associated with insurance.

¹⁴ GAO FDIC auditors working on 9/30/13 statements; if anything surfaces from later research they will send FASAB staff an email.

6. If you are currently reporting under FASB 5 (ASC 450) for Contingent Liabilities, would you consider switching to FASB’s proposed Update for Insurance Contracts? Why, Why not?	
Federal FASB GAAP Entities	Answers
FDIC	GAO auditor stated that this proposed standard does not apply to FDIC. Therefore, FDIC will not switch since ASC 450, Contingent Liabilities, is straight forward for FDIC’s reporting.
PBGC	No, FASB’s proposed Update for Insurance Contracts is not compatible with PBGS’s financial reporting as described in our response for Q3.
FCSIC	FASAB additional clarification question to FCSIC: If the answer to Q2 is NO that FCSIC <u>does not meet</u> the definition AND FASB adopts the proposed insurance contract standards which will update topic 944, will FCSIC then report under FASB Statement #5 - contingent liability? Yes, I would expect any <u>future liabilities to essentially be booked under a traditional FAS 5¹⁵ type accounting model.</u>
OPIC	At this time OPIC cannot make that determination until extensive research is conducted. (Refer also to Answer #5)

50% of federal FASB reporters will **NOT consider switching** to FASB’s proposed Update for Insurance Contracts.

25% of federal FASB reporters **will consider switching** from FASB ASC 944, Financial Services—Insurance to ASC 450, Contingencies¹⁶.

25% of federal FASB reporters **cannot make the determination** to switch to FASB’s proposed Update for Insurance Contracts without extensive research.

¹⁵ FASB ASC 450, Contingencies.

¹⁶ This change in accounting standards would result from FCSIC’s NOT meeting the proposed insurance contract definition. They assume that if it becomes GAAP, as currently written, that they would commence to use the ASC 450, Contingencies to report these liabilities.

Staff Analysis

From research and interviews of federal insurance FASB GAAP reporters, staff has identified that:

FASB proposed definition of an insurance contract:

- 75% of federal insurance programs interviewed assert that they do **NOT** meet this definition.

Measurement Models – Premium Allocation Approach (PAA) or Building Block Approach (BBA):

- Only 25% believe their program fits the PAA Approach
- 75% believe their programs do NOT fit the PAA Approach

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- 100% believe their programs do not fit the BBA Approach

Implementation of Topic 834 – Insurance Contracts Standards:

- 75% would **NOT** switch to FASB Topic 834,
 - One would move from the current Insurance Topic 944 to Topic 450, Contingencies
 - Three would continue to report under Topic 450, Contingencies
- 25% cannot determine at this time, without more extensive research, if implementation is appropriate

Status of FASB Insurance Contracts ED:

In addition, staff listened to the FASB insurance contracts roundtable on December 2, 2013, to track the status of FASB’s insurance contracts ED. See Attachment 4 for the related news report.

<p>Question: Is the FASB proposed “insurance <u>contracts</u>” definition suitable to “federal insurance <u>programs</u>”?</p>

Staff Recommendation:

Staff believes it would be difficult to apply the FASB proposed “insurance contracts” definition and instead plans to continue research to develop a definition for federal insurance and non-loan guarantee programs.

This belief is based on the **unique characteristics** of federal insurance programs as follows:

1. Federal programs that we call “insurance” programs may have **regulatory aspects** which:
 - a. Make identification of a “contract” challenging
 - b. Obscure acceptance of “significant insurance risk¹⁷” because the program spreads the risk among the regulated entities (see Chart #1) rather than transferring risk to the regulator (federal program) through a legally prescribed premium.
2. The federal program “policy holder” does not always identify a “**designated beneficiary.**” Rather the law regulating the federal program, in its ultimate goal to protect the U.S. economy, identifies what group of individuals they have designated as beneficiaries. For Example:

¹⁷ See footnotes 3 and 4.

Chart #1

Federal Program	Funding	Regulated Entities	Designated Beneficiaries
FDIC	The... (FDIC) is the independent deposit insurance agency created by Congress in 1933 to maintain stability and public confidence in the nation's banking system. Provisions that govern the operation of the FDIC are generally found in the Federal Deposit Insurance (FDI) Act, as amended (12.U.S.C. 1811, <i>et seq.</i>) The DIF is primarily funded by deposit insurance assessments and may borrow to meet funding needs. ¹⁸	Banks	Depositors ¹⁹
PBGC	PBGC is funded by assets from trustee plans and premiums from plan sponsors, not by taxpayer dollars. Unfortunately, our premiums are set in law ²⁰ . They're both too inflexible — so that some plans are unfairly paying for the risks of others — and too low to cover PBGC's benefit guarantee levels. ²¹	Certain employers with defined benefit pension plans	Employees with defined benefit pension plans ²²
FCSIC	FCSIC (the Corporation) operates with no appropriated funds. We collect insurance premiums from each Farm Credit System bank that issues insured obligations. ²³ These premiums and the income from our investment portfolio provide the funds necessary to fulfill our mission. ²⁴ If the Corporation does not have sufficient funds to ensure payment on insured obligations, System banks will be required to make payments under joint and several liability as required by section 4.4(a)(2) of the Farm Credit Act. ²⁵	Farm Credit System cooperative lending institutions	Investors in the Farm Credit System (FCS) ²⁶

¹⁸ FDIC, FY 2012 Annual Report, page 67-68.

¹⁹ Up to \$250,000 per deposit.

²⁰ See footnote #13 on ERISA.

²¹ PBGC, FY 2013 Annual Report, page v.

²² "Each year PBGC establishes a maximum benefit based on a formula prescribed by federal law" Quote by Mr. Winters from PBGC meeting with FASAB staff on November 19, 2013. See attachment 3, page 23.

²³ Under section 4.2(c) or (d) of the Farm Credit Act.

²⁴ FCSIC, FY 2012 Annual Report, page 19.

²⁵ FCSIC, FY 2012 Annual Report, page F-11

²⁶ FCSIC 2012 Annual Report, Page 10: The...FCS is a federally chartered network of cooperative lending institutions owned by the agriculture and rural customers it serves.

NEXT STEPS

Staff Recommendation:

Staff recommends that we:

- Develop a general definition and specific characteristics of federal insurance and guarantee programs.
- Evaluate the similarities and differences between loan guarantees and federal insurance and non-loan guarantees.
 - Get a clearer understanding of the credit reform standards and how that approach could assist in considering revisions to our current insurance and guarantee standards.
- Continue to monitor the development of the FASB Insurance Contracts Standard (Topic 824) ED to identify any significant changes that could impact the:
 - Federal insurance FASB GAAP reporters, and subsequently the
 - Government-wide report
 - Consolidation
 - Consistency

Question for the Board

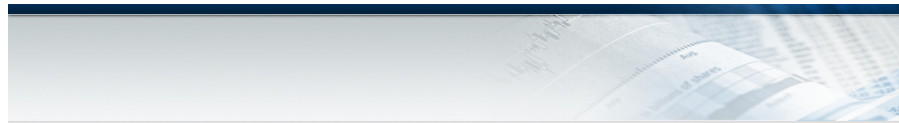
Is the FASB proposed “insurance contracts” definition suitable to “federal insurance programs”?

TAB F – Attachments

Risk Assumed: Insurance and Guarantees

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TAB F – Attachment 1:



Insurance Contracts

Summary of project and proposed Update

Larry Smith, FASB member

Jennifer Weiner, FASB senior practice fellow



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Why is the FASB issuing a Proposed Accounting Standards Update?

- Existing U.S. GAAP guidance on accounting for insurance contracts is comprehensive but:
 - Consists of multiple models developed incrementally over time
 - Has not been subject to comprehensive reconsideration by FASB before this project
- FASB/IASB stakeholders overwhelmingly favored joint project
- Stakeholders identified several areas of improvement to long-duration models and short-duration model
- Aspects of existing accounting models inconsistent with more recently issued guidance and areas of diversity in practice

Definition of an insurance contract

- A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to **compensate** the policyholder or its designated beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder
- Insurance risk can be either underwriting risk **or timing risk**
- Significant insurance risk cannot exist unless there is at least 1 scenario in which the present value of net cash outflows can exceed the present value of cash inflows

Applies to all contracts meeting the definition of an insurance contract regardless of type of company issuing the contract

Building block approach (BBA)

Fulfillment cash flows

- Present value of unbiased, probability-weighted estimate of future cash outflows less future cash inflows
- Cash flows include all costs directly attributable to or allocable to fulfillment of contracts including expected value of options and guarantees
- Discount rate reflects the characteristics of the liability
- Premium recognized as revenue over the coverage period in proportion to the value of coverage and any other services
- Exclude from revenue and expense amounts expected to be returned to the policyholder or its beneficiary regardless of an insured event occurring
- Recognize changes in assumptions in net income, except for changes in the discount rate which are recognized in other comprehensive income

Margin

- Expected cash inflows greater than expected cash outflows
- Recognize as revenue as the uncertainty (the risk) in cash flows decreases
- Present acquisition costs incurred as an offset to the margin and recognize as an expense in same pattern as margin

Premium allocation approach (PAA)

Receivable

- Expected future premiums within boundary of existing contract
- Adjust for time value if liability for remaining coverage is adjusted

Liability for remaining coverage (UPR)

- Contractual premiums within boundary of existing contract
- Adjust for time value if contract has significant financing component unless meet practical expedient
- Reduce for qualifying acquisition costs incurred, if not immediately expensed
- Adjust liability if portfolio of insurance contracts is onerous
- Recognize revenue for reduction in the liability for remaining coverage on basis of passage of time or expected timing of incurred claims
- Exclude from revenue and expense amounts expected to be returned to the policyholder or its beneficiary regardless of an insured event occurring

Liability for incurred claims (reserves)

- Recognize expense when claim is incurred
- Present value of unbiased, probability-weighted estimate of future cash outflows for claims that have been incurred
- Discounting not required if effects are immaterial or when incurred claims are expected to be paid within one year of insured event
- Recognize changes in discount rates in other comprehensive income

TAB F – Attachment 2:

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2.B	Financial Accounting Standards Board (FASB) Summary of Proposed Accounting Standards Update (proposed Update) – Insurance Contracts (Topic 834) Issued June 27, 2013	7
2.C	FASB (Appendix A) Comparison of Existing U.S. GAAP Guidance and Guidance on Proposed Update	9

2.A - October 18, 2013, Query Letter to Federal Insurance FASB Reporters:

On June 27, 2013, the Financial Accounting Standards Board (FASB) published their proposed standards update for Insurance Contracts (Topic 834). One of FASAB's objectives is to evaluate the potential impact of this proposed standard, on those federal entities that follow FASB GAAP (see attachments).

FASAB has identified your entity as following FASB GAAP. As a result, we would like to understand the potential impact of this new FASB insurance contracts proposed standard on FCSIC.

During our conversation, you mentioned that you did not believe that the proposed insurance contract standard would impact FCSIC, since you do not issue insurance contracts and are self insured. However, you said that you would review the attached summary and below questions to see what information that you can provide us. We also agreed to touch base on the phone to see if a meeting is still necessary. In order to meet my Board deadline, I will need your responses back by November 1st.

Questions:

1. Are you familiar with FASB's exposure draft on Insurance Contracts (Topic 834) released on June 27, 2013?
2. Do you currently follow FASB's Accounting Standards Update 2010-26 Financial Services—Insurance (Topic 944), Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts or FASB Standard No. 5 for Contingent Liabilities?
3. Do you believe any programs within your entity would meet FASB's definition (Attachment A-page 3) of an insurance contract and therefore be within the scope of the FASB Insurance Contracts proposal? If so, why? If not, why not?
4. Do you believe that your entity's insurance product(s) has characteristics that align with either the FASB's proposed premium allocation approach (PAA) or building block approach (BBA)? Please elaborate on your response.
5. What benefits or drawbacks do you see in applying the PAA and/or the BBA measurement approach?
6. Do you have any additional comments on the recognition of your entity's insurance activities that would benefit FASAB in developing the federal GAAP for risk associated with insurance?

7. If you are currently reporting under FASB 5 for Contingent Liabilities, would you consider switching to FASB's proposed Update for Insurance Contracts? Why, Why not?

Also, per your spam concern, please let me know if you received this email. I appreciate your time and look forward to working with you.

Thanks,

Robin

Robin M. Gilliam, CPA, PMP
Assistant Director, FASAB
(202) 512-7356

Disclaimer: 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.

2.B - Financial Accounting Standards Board (FASB) Summary of Proposed Accounting Standards Update (proposed Update) – Insurance Contracts (Topic 834) Issued June 27, 2013¹

Existing U.S. generally accepted accounting principles (GAAP) for insurance contracts have evolved over many years as a result of new insurance products and new contract terms and features. Those changes have resulted in multiple models that vary based on the nature of the insurance contract. Existing U.S. GAAP on insurance applies only to insurance entities and not to contracts issued by noninsurance entities that contain identical or similar economic characteristics to insurance contracts.²

The guidance in this proposed Update would apply to all entities that issue insurance contracts as defined in this proposed Update (including entities other than insurance companies) or that hold reinsurance contracts...³

Insurance Contract

A contract under which one party (the issuing entity) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or its

¹ All the information provided in this summary was taken from the FASB, Exposure Draft, Proposed Accounting Standards Update, Insurance Contracts (Topic 834). All future footnotes will only reference the page number and section, where the information can be found. Note that FASAB might have **adjusted** the format, but not the content, to highlight specific information.

² Page 1, Section: Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

³ Page 3, Section: Who Would Be Affected by the Amendments in This Proposed Update?

designated beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder.⁴

The guidance establishes a principle that classifies insurance contracts under one of two measurement models, referred to as the **building block approach** (for most life, annuity, and long-term health contracts) and the **premium allocation approach** (for most property, liability, and short-term health contracts).⁵

The guidance in this proposed Update would require an entity to apply one of two models on the basis of characteristics of the insurance contracts.

1. The **premium allocation approach** would be applied if:
 - the coverage period of an insurance contract is one year or less, or,
 - at contract inception if it is unlikely that during the period before a claim is incurred there will be significant variability in the expected value of the net cash flows required to fulfill the contract.
2. The **building block approach** would be applied to all other contracts.⁶

⁴ Page 28, Section: FASB Definition in Glossary

⁵ Page 242, Section: Background, Information, Basis for Conclusions and Alternative Views, Introduction

⁶ Page 3, Section: What Are the Main Provisions?

Appendix A: Comparison of Existing U.S. GAAP Guidance and the Guidance in this Proposed Update

A1. The table provides a high level side-by-side comparison of existing U.S. GAAP and the guidance in this proposed Update for an insurance entity that is currently applying Topic 944 to its insurance contracts. It is intended to highlight the more significant changes between existing U.S. GAAP and the proposed Update and not the entirety of existing U.S. GAAP guidance or the proposed Update included herein.

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
Significant insurance risk	If it is reasonably possible that an insurance entity may realize a significant loss.	An insurance entity is exposed to a significant loss in any scenario that has commercial substance.
Definition of portfolio	Contracts should be grouped to be consistent with the insurer's manner of acquiring, servicing, and measuring the profitability of its insurance contracts.	A group of insurance contracts that: <ol style="list-style-type: none"> 1. Are subject to similar risks and priced similarly relative to the risk taken on 2. Have similar duration and similar expected patterns of release of the margin
Determining which measurement model to apply: short-duration or long-duration	<p>Contracts are accounted for using the short-duration model if the contracts provide insurance protection for a fixed period of short duration and enables the insurer to cancel the contract or to adjust the provisions of the contract at the end of the contract period.</p> <p>Contracts are accounted for using the long-duration model generally if the contract is not subject to unilateral changes in its provisions and requires the performance of various functions and services for an extended period.</p>	<p>Apply the building block approach unless the following characteristics are present, in which case, apply the premium allocation approach:</p> <ol style="list-style-type: none"> 1. The coverage period of the insurance contract is one year or less, or 2. At contract inception, it is unlikely that during the period before a claim is incurred there will be significant variability in the expected value of the net cash flows required to fulfill the contract <p><i>(It is presumed that the building block approach will be used to measure most contracts that are accounted for using the long-duration model and the premium allocation approach will be used to measure most contracts that are accounted for using the short-duration model under existing U.S. GAAP.)</i></p>
Traditional long-duration insurance contracts (Liability for future policy benefits) (For contracts measured using the	<p>Measure the liability for future policy benefits as the present value of estimated future policy benefits and related expenses (including a provision for adverse deviation which is often based on a percentage of the expected cash outflows) less the present value of estimated future net premiums.</p> <p>The discount rate is based on the estimated pre-tax investment yields (net of related expenses) expected at the contract issuance date based on actual yields, trends in yields, and portfolio mix and maturities. The rate typically is adjusted for defaults and</p>	<p>Measure and present an insurance contract as:</p> <ol style="list-style-type: none"> 1. The fulfillment cash flows which represent the expected present value of future cash outflows less the expected present value of future cash inflows. In general these will be determined similarly to the current process but, where based on historical experience, will need to reflect projections for fluctuations in historical rates and not include adjustments for parameter risks and pandemics, which should be reflected in the probability-weighted estimates. 2. A margin when the fulfillment cash inflows are greater than the cash outflows; a loss

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
building block approach in the proposed Update)	<p>reinvestment risks. Interest expense for the accretion on the discounted liability is presented with changes in the liability.</p> <p>The assumptions for measuring traditional life insurance benefit liabilities are locked in at inception and reset only if a premium deficiency emerges.</p> <p>Changes in the liability for future policy benefits are recognized in net income. This results in the release of the implicit gain, adjusted for changes in assumptions, over time as the liability is released.</p>	<p>when the fulfillment cash inflows are less than the cash outflows.</p> <p>Unconditional premium receivables should be recognized as a separate asset.</p> <p>The discount rates should reflect the characteristics of the insurance liability.</p> <p>The fulfillment cash flows should reflect all available information at the end of the reporting period, i.e. updated each reporting period.</p> <p>Changes in the fulfillment cash flows, except for the effects from changes in discount rates, should be recognized in net income.</p> <p>Changes in the fulfillment cash flows due to changes in the discount rates should be recognized in other comprehensive income.</p> <p>Interest expense to reflect accretion on the insurance related balances should be recognized based on the discount rates at the inception of the contracts or adjusted rates that reflect changes in estimated interest crediting and related ultimate expected cash flows. Interest credited, if applicable, and interest expense that reflects the accretion of the discounted liability should be presented with net investment income.</p> <p>Acquisition costs paid should reduce the margin. In determining whether the margin is onerous, entities should consider expected acquisition costs. See section on acquisition costs.</p> <p>If a portfolio of contracts is determined to be onerous, an entity should immediately recognize the remaining margin.</p>
Universal life-type contracts, deferred annuities and variable and equity-based life and annuity products (Policyholder account)	<p>The liability is equal to the account balance. A profit margin is embedded in the account value (and in the unearned revenue liability when amounts have been assessed for future periods service) and is recognized over time as fees are withdrawn from the account balance (and based on a pattern of estimated gross profits for amounts previously assessed for future periods) and recognized as income. Interest credited to policyholder account balances is generally presented as a separate line item with other insurance contract expenses.</p> <p>Where an insurance benefit feature results in</p>	<p>These contracts are accounted for the same as all other insurance contracts measured using the building block approach. That is, the liability is measured as the fulfillment cash flows, discounted using rates that reflect the characteristics of the insurance liability, plus a margin. See section on liability for future policyholder benefits.</p> <p>The fulfillment cash flows should include the following that are not considered in existing U.S. GAAP for universal life-type contracts, deferred annuities and variable and equity-based life and annuity products:</p> <ol style="list-style-type: none"> 1. Expected surrenders and surrender

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
balances and separate account liabilities) <i>(For contracts measured using the building block approach in the proposed Update)</i>	<p>an expectation of profits in the early years followed by losses in the later years from that feature, an additional liability (typically included in the liability for future policy benefits) is recognized for the expected benefits in excess of expected assessments and the related policyholder account balance determined by a formulaic calculation.</p> <p>Any benefit in excess of the account balance (e.g., death benefit) is included in the measurement of the liability for future policy benefits.</p>	<p>charges</p> <ol style="list-style-type: none"> Expected fees (cost of insurance, mortality and expense, and asset management fees), Expected value of all option and guarantee features within the contract, that are not accounted for as embedded derivatives, measured based on the expected cash flows (includes guarantees and options not recognized under existing U.S. GAAP until the option is exercised or the guarantee is in the money and guarantees and options measured using a formulaic calculation under existing U.S. GAAP).
Separate account assets <i>(Segregated fund arrangements in the proposed Update)</i>	<p>To apply specialized accounting:</p> <ol style="list-style-type: none"> The separate account is recognized legally; The separate account assets supporting the contract liabilities are insulated legally from the general account liabilities of the insurance entity The entity must invest the policyholder's funds (as directed by the policyholder) in designated investment alternatives or in accordance with specific investment objectives or policies All investment performance, net of contract fees and assessments, must be passed through to the individual policyholder <p>The portion of separate account assets representing contract holder funds should be measured at fair value initially and subsequently.</p> <p>Assets underlying an insurance entity's proportionate interest in a separate account (seed money or other investment) should be classified and measured as if the assets were held directly by the general account rather than through the separate account structure; if certain criteria are met, the assets can be measured using the held for sale accounting for the respective assets.</p> <p>Separate account assets and the related liability are presented separately on the statement of financial position.</p> <p>Investment income on separate account assets and the investment expense representing the pass-through of the investment income are reported net in net income.</p>	<p>To apply specialized accounting:</p> <ol style="list-style-type: none"> The entity must invest the policyholder's funds (as directed by the policyholder) in designated investment alternatives or in accordance with specific investment objectives or policies All investment performance, net of contract fees and assessments, must be passed through to the individual policyholder <p>All assets held in segregated fund arrangements, including insurers' proportionate interests, should be recognized at fair value with changes recognized in net income.</p> <p>Segregated asset and liability balances should be presented with the appropriate category of financial instruments (although could be identified and presented separately) and with the insurance liability, respectively.</p> <p>Investment income on segregated assets should be included in net income in the statement of comprehensive income separate from investment expense (that is, pass-through of results).</p> <p>If not presented separately, segregated fund assets and the related investment income/expense should be disclosed.</p>

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
Participation features	<p>Contractual income-based dividend provisions for participating contracts are based on net income that includes adjustments between general purpose and statutory-basis financial statements that will reverse and enter into future calculations of the dividend provision.</p> <p>To the extent that unrealized holding gains or losses from securities classified as available-for-sale would result in adjustments of policyholder liabilities, those balance sheet amounts should be adjusted with corresponding credits or charges reported directly to other comprehensive income.</p> <p>When there are no restrictions on the amount of dividends to pay, the expected dividends, sometimes determined using dividend scales, are accrued over the life of the contract, typically as the premium is earned or paid.</p>	<p>If a participation feature contractually depends wholly or partly on the performance of an underlying item:</p> <ol style="list-style-type: none"> 1. As measured in accordance with U.S. GAAP, the measurement of the liability should reflect the measurement of the underlying item. 2. Based on something other than the measurement in accordance with U.S. GAAP and the difference: <ol style="list-style-type: none"> a. Reflects a timing difference that will reverse and enter into future calculations of participating benefits, the measurement of the liability should be adjusted if necessary in order to reflect the measurement of the underlying items in accordance with U.S. GAAP. b. Does not reflect such a timing difference, the measurement of the liability should be based on the contractual feature (e.g., the contractual feature passes through to the policyholder the fair value of the underlying). <p>Changes in the measurement of the liability for participation features that contractually depends wholly or partly on the performance of an underlying item should be presented in the same manner as the changes in the underlying item (that is, in net income or other comprehensive income) except in 2.b. above in which case the changes</p> <p>Non-contractual or discretionary participation features should be included in the measurement of the fulfillment cash flows based on expected cash flows from these features.</p>
Revenue and expense recognition for long duration contracts <i>(For contracts measured using the building block approach in the proposed Update)</i>	<p>For traditional insurance contracts, revenue is generally recognized when premium is due (and for the amount due) and an expense is recognized for the change in the liability (that is, the reduction in the future premium results in an expense and an increase in the liability).</p> <p>For universal life-type contracts, deferred annuities and variable and equity-based life and annuity products, revenue is recognized for amounts assessed against policyholders in the period that the amounts are assessed unless evidence indicates that the amounts are designed to compensate the entity for services to be provided over more than one period in which case revenue should be recognized over that period. Expenses are recognized for the benefits/ claims in excess</p>	<p>Exclude from revenue the amounts that are estimated to be returned to the policyholder regardless of the occurrence of an insured event. See section on estimated returnable amounts.</p> <p>Recognize revenue for the fulfillment of cash flows (including accretion of interest) over the coverage period in proportion to the value of coverage and any other services.</p> <p>Recognize claims, benefits and related expenses (in excess of the repayment of estimated returnable amounts) when the claims are incurred and other non-claims fulfillment costs when those costs are incurred.</p> <p>Changes in the margin are recognized over the</p>

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
	of the related policyholder account balances and amounts credited to policyholders.	<p>coverage and settlement periods as the entity satisfies its performance obligation to the policyholder (that is, as it is released from exposure to risk as evidenced by a reduction in the variability of cash outflows). The margin should not be adjusted to offset changes in expected cash flows, but in determining its release from risk entities should consider changes in actual and expected cash flows.</p> <p>The margin recognized should be grossed-up for acquisition costs. That is, the total insurance contract revenue (revenue for the fulfillment of cash flows plus the release of the margin) over the life of a contract should represent the consideration received plus accretion of interest (less any estimated returnable amounts).</p>
Unearned premium reserve <i>(The liability for remaining coverage for contracts measured using the premium allocation approach in the proposed Update)</i>	Unearned premium reserve is recorded for the amount of premium related to the unexpired period of the contract (or unexpired proportion of risk) with a corresponding receivable also recognized.	<p>A liability for remaining coverage is recorded for the amount of premium related to the unexpired period (or unexpired proportion of risk) of the contract with a corresponding receivable also recognized.</p> <p>Expectations of future changes in coverage, such as policyholder cancellations, should not be considered.</p> <p>The liability for remaining coverage and any premiums receivable should be adjusted to reflect the time value of money if the contract has a financing component that is significant as defined by Topic 606. However, if the entity expects, at contract inception, that the time period between the payment by the policyholder of all or substantially all of the premium and the entity providing the corresponding part of the coverage is one year or less, time value of money need not be reflected.</p> <p>When the time value of money is reflected, the discount rates should be based on the discount rates determined at inception of the contracts and not updated.</p> <p>The liability for remaining coverage is reduced for specified acquisition costs paid. See section on acquisition costs.</p>
Revenue recognition – unearned premium reserve	The unearned premium reserve is reduced and premium revenue is recognized for the corresponding amount over the coverage period in proportion to the amount of insurance protection provided.	<p>The liability for remaining coverage should be recognized:</p> <ol style="list-style-type: none"> 1. On the basis of time, but 2. On the basis of the expected timing of incurred claims and benefits, if that pattern differs significantly from the passage of

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
<i>(The liability for remaining coverage for contracts measured using the premium allocation approach in the proposed Update)</i>		<p>time</p> <p>A corresponding amount of premium revenue should be recognized, grossed up for acquisition costs. That is, the total premiums earned over the life of a contract should represent the consideration received plus accretion of interest, if applicable (less any estimated returnable amounts).</p>
<p>Premium deficiency reserve</p> <p><i>(Onerous contract liability for contracts measured using the premium allocation approach in the proposed Update)</i></p>	<p>If the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs, and maintenance costs exceeds related unearned premiums (and expected investment income if elected to consider), then unamortized acquisition costs are expensed and any additional deficiency is recorded as an additional liability.</p> <p>Liabilities for catastrophic events are not typically recognized until an event(s) has occurred and it adversely affects the policyholder.</p>	<p>When facts and circumstances indicate that a portfolio of contracts may be onerous, perform an onerous contract test and recognize an additional onerous contract liability and a corresponding expense for the excess of the fulfillment cash flows relating to future claims and expenses over the premiums, net of acquisition costs.</p> <p>The onerous contract test should be performed and the liability should be measured on a basis that is consistent with the measurement of the liability for incurred claims for that portfolio of insurance contracts. That is, either on a discounted or undiscounted basis. The test and the measurement of the additional liability should not consider expected investment income.</p> <p>Liabilities for catastrophic events should be considered in the onerous contract test which should include the expected cash flows as of the reporting date.</p>
<p>Reserves (or liability for unpaid claims)</p> <p><i>(The liability for incurred claims for contracts measured using the premium allocation approach in the proposed Update)</i></p>	<p>A liability for unpaid claims, including incurred but not reported claims and related claim adjustment expenses is recognized as an expense and a liability should be accrued when the insured event occurs. Changes in assumptions are recognized in net income each reporting period.</p> <p>The recorded reserves are based on management's best estimate which includes the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. The determination of the best estimate typically starts with the actuarial central estimate, the objective of which is to</p>	<p>The liability for incurred claims, including incurred but not reported claims and related claim adjustment expenses should be recognized as an expense and a liability should be accrued when the insured event occurs. Changes in assumptions are recognized in net income each reporting period.</p> <p>The liability for incurred claims should be measured as the present value of the unbiased, probability-weighted estimate of expected fulfillment cash flows, the objective of which is to recognize the statistical mean of possible scenarios that incorporate all relevant information.</p> <p>The liability for incurred claims should be discounted using discount rates that reflect the</p>

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
	<p>determine the mean of the expected value over a range of reasonably possible outcomes using multiple estimation methods.</p> <p>Reserves are measured on a discounted basis when the payment pattern and ultimate costs are fixed and determinable on an individual claim basis. As such, most reserves are measured on an undiscounted basis, except workers' compensation indemnity claims, structured settlements, and medical malpractice settlements.</p>	<p>characteristics of the liability. However, an entity need not apply discounting when the effects are immaterial or when the incurred claims are expected to be paid within 12 months of the occurrence of the insured event.</p> <p>Changes in the fulfillment cash flows due to changes in the discount rates should be recognized in other comprehensive income.</p> <p>Interest expense to reflect accretion on the insurance related balances should generally be recognized based on the discount rates at the inception of the contracts. Interest expense that reflects the accretion of the discounted liability should be presented with net investment income.</p>
Acquisition costs	<p>Acquisition costs that relate directly to the successful acquisition of new or renewal insurance contracts are capitalized and presented separately on the statement of financial position.</p> <p>Expected acquisition costs are included in the measurement of the liability for future policyholder benefits for traditional long-duration insurance contracts.</p> <p>Expected acquisition costs are not included in the short-duration model.</p> <p>Expected acquisition costs are not included in the measurement of the liability for non-traditional long-duration insurance contracts but are considered in the determination of the estimated gross margin which is used to determine the amortization of deferred policy acquisition costs</p> <p>For contracts accounted for under the short-duration model and traditional long-duration insurance contracts, deferred acquisition costs are amortized in proportion to the premium revenue recognized.</p> <p>For other long-duration insurance contracts, deferred acquisition costs are amortized based on the pattern in which the estimated gross profit is expected to be recognized over the life of a portfolio of contracts. The deferred acquisition cost balance and the prior amortization is adjusted for favorable and unfavorable changes, retrospectively with a cumulative catch-up adjustment recognized in net income.</p>	<p>Acquisition costs that are directly related to the entity's selling efforts that result in obtaining the contracts in a portfolio should be considered in the measurement of the margin.</p> <p>Although included in existing U.S. GAAP, direct-response advertising costs are not included as acquisition costs that should be considered in the measurement of the insurance contract liabilities.</p> <p>Expected acquisition costs are considered in determining whether the portfolio of insurance contracts is onerous. That is, whether the margin for contracts measured using the building block approach or the liability for remaining coverage for contracts measured using the premium allocation approach is sufficient to cover the expected fulfillment costs and unamortized acquisition costs incurred and/or expected to be incurred.</p> <p>When acquisition costs are paid, the margin for contracts measured using the building block approach, and the liability for remaining coverage for contracts measured using the premium allocation approach, should be reduced.</p> <p>Acquisition costs should be recognized as an expense in the same pattern as the margin for contracts measured using the building block approach or the liability for remaining coverage for contracts measured using the premium allocation approach is recognized.</p>

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
Estimated returnable amount (In the proposed Update applicable to contracts measured using both the building block approach and the premium allocation approach)	<p>For universal life-type contracts, deferred annuities and variable and equity-based life and annuity products, premium which is allocated to the policyholders account balance is not recognized as revenue and the return of the account balance is not recognized as an expense.</p>	<p>If a feature of an insurance contract requires an entity to pay amounts to policyholders or their beneficiaries regardless of whether an insured event occurs (estimated returnable amount), an entity shall:</p> <ol style="list-style-type: none"> Exclude from revenue the amounts that have been received from the policyholder for such repayments Exclude those repayments from the expenses for claims and benefits when incurred
Reinsurance ceded	<p>Expected gains (that is, recoveries are expected to exceed the premiums paid) from reinsurance contracts are deferred and recognized over the coverage period, settlement period or life of the underlying reinsurance contracts, as applicable (if prospective reinsurance) or settlement periods (if retroactive reinsurance which typically only applies to short-duration contracts).</p> <p>Expected losses (that is, premiums paid are expected to exceed recoveries) from reinsurance contracts for prospective events are recognized over the coverage period and expected losses for events that occurred prior to entering into the reinsurance contract are recognized immediately.</p> <p>The reinsurance recoverable should reflect the assumptions consistent with those used in measuring the underlying insurance contract liabilities.</p> <p>Ceded reinsurance recoverables and payables are recognized separately from the underlying insurance contract liabilities in the statement of financial position.</p> <p>The measurement of the reinsurance recoverable should consider counterparty credit losses.</p>	<p>Expected gains (that is, recoveries are expected to exceed the premiums paid) from prospective reinsurance contracts are deferred and recognized over the coverage period if measured using the premium allocation and over the coverage and settlement periods if measured using the building block approach. Expected gains from retroactive reinsurance contracts are deferred and recognized over the settlement period.</p> <p>Expected losses (that is, premiums paid are expected to exceed recoveries) from reinsurance contracts for prospective events are recognized over the coverage period and expected losses for events that occurred prior to entering into the reinsurance contract are recognized immediately.</p> <p>The reinsurance recoverable should reflect the fulfillment cash flows using assumptions consistent with those used to measure the corresponding part of the fulfillment cash flows of the underlying insurance contracts without reference to the margin on the underlying contracts.</p> <p>The measurement of counterparty credit losses for the reinsurance recoverable should be measured in accordance with the financial instruments impairment guidance.</p>

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
	<p>Premiums ceded and recoveries recognized under ceded reinsurance contracts are required to be reported in the statement of earnings, as separate line items or parenthetically, or disclosed. Often, these amounts are disclosed.</p> <p>Proceeds that represent recovery of acquisition costs (e.g., ceding commissions) are recognized as a reduction in the related deferred acquisition costs.</p> <p>Cash flows impacted by contingent provisions that affect the amount of premiums or ceding commissions upon the occurrence of a triggering event(s) (that is claims or benefits experience, often referred to as "loss sensitive features") often follow the form of the adjustment. That is, the premium and/or commissions are adjusted. (Note: this also applies to directly written contracts and reinsurance assumed.)</p>	<p>Ceded reinsurance recoverables and payables should be recognized separately from the underlying insurance contract liabilities in the statement of financial position and should be disaggregated between those amounts for reinsurance contracts measured using the building block and premium allocation approaches.</p> <p>Premiums ceded and losses recovered from ceded reinsurance contracts should be presented separately from revenue and expenses on the underlying insurance contracts, disaggregated between those amounts for reinsurance contracts measured using the building block and premium allocation approaches.</p> <p>The premiums ceded should be recognized in net income in the statement of comprehensive income, net of ceding commissions and other fees expected to be received from the reinsurer that are not contingent on claims and benefits experience.</p> <p>Cash flows impacted by contingent provisions that affect the amount of premiums or ceding commissions upon the occurrence of a triggering event(s) (that is claims or benefits experience, often referred to as "loss sensitive features") should be presented as part of the claims and benefits cash flows rather than as an adjustment to premiums. (Note: this also applies to directly written contracts and reinsurance assumed.)</p>
Foreign currency	For purposes of determining the exchange rate to be used in remeasurement, unearned premium reserves, deferred acquisition costs and the amortization thereof, except policy acquisition costs and the amortization thereof for life insurance companies, are considered non-monetary items. Other insurance related balances such as the liability for future policyholder benefits and the liability for incurred claims are classified as monetary.	All insurance contract related financial statement components should be classified as monetary for purposes of determining the exchange rate to be used in remeasurement.
Business combinations	An entity measures at fair value the assets and liabilities arising from the rights and obligations of the insurance and reinsurance	An entity should measure at fair value the assets and liabilities arising from the rights and obligations of the insurance and reinsurance

	Existing U.S. GAAP	Amendments in the FASB's Proposed Update
	<p>contracts acquired in the business combination in the following components:</p> <ol style="list-style-type: none"> 1. Assets and liabilities measured in accordance with the acquirer's accounting policies for insurance and reinsurance contracts that it issues or holds <p>An intangible asset (or occasionally another liability), typically referred to as the value of business acquired (VOBA) or present value of future profits (PVFP) representing the difference between the fair value of the contractual insurance and reinsurance assets acquired and liabilities assumed and the measurement of the assets and liabilities.</p> <p>The intangible is amortized in a manner that is consistent with the amortization of deferred acquisition costs and is subject to a loss recognition test.</p>	<p>contracts acquired in the business combination in the following components:</p> <ol style="list-style-type: none"> 1. Assets and liabilities measured in accordance with the acquirer's accounting policies for insurance and reinsurance contracts that it issues or holds 2. A margin if the fair value of the contractual insurance and reinsurance assets acquired and liabilities assumed exceed the measurement of the assets and liabilities; a loss if the measurement of the assets and liabilities exceed the fair value of the contractual insurance and reinsurance assets acquired and liabilities assumed. <p>The margin should be presented with the entities margin on its insurance contracts directly written and recognized in the same manner (that is, as the entity is released from risk).</p>

TAB F – Attachment 3:

Notes from November 19, 2013, Meeting with PBGC

Participants:

Marty Boehm, Director, Contracts and Controls Review Department (CCRD), PBGC

Gowon Thorpe, Auditor, CCRD, PBGC

Ted Winter, Director, Financial Operations Department (FOD), PBGC

Ray Bryant, Team Leader, Corporate Financial Policies and Procedures Group (CFPPG), FOD, PBGC

Mary Sasscer, Accountant, CFPPG, FOD, PBGC

Wendy Payne, Executive Director, FASAB

Robin Gilliam, Assistant Director, FASAB

Monica Valentine, Assistant Director, FASAB

Background:

The Federal Accounting Standards Advisory Board (FASAB) is currently undertaking the research for developing standards for the risk assumed project – insurance and guarantee phase I. As part of our research we are reaching out to the federal insurance and guarantee entities that are Financial Accounting Standards Board (FASB) reporters to understand the impact, if any, of the proposed FASB Insurance Contracts Standards (Topic 834) Exposure Draft (ED) issued on June 27, 2013.

On October 18th, 2013, FASAB sent an email to PBGC requesting a meeting with a list of seven discussion questions. On October 30th, 2013, PBGC returned the following email responses⁷:

⁷ Answers are captured in the Staff Analysis section of the TAB F Memo

Discussion:

Ms. Gilliam opened the meeting with introductions and requested a brief summary of PBGC's programs and what is guaranteed.

Mr. Winter explained that PBGC is responsible to carry out Title IV of the Employee Retirement Income Security Act (ERISA) signed into law in 1974. ERISA Title IV describes exactly what is guaranteed for the single and multiemployer plan insurance programs. Each year PBGC establishes a maximum benefit based on a formula prescribed by federal law.

Mr. Boehm also provided the following information:
Pointed FASAB to a recent press release that, beginning 2014, increases "the maximum yearly guarantee for a 65-year-old retiree to almost \$59,320 – a 3.2% increase from the \$57,500 rate in 2013."⁸

Mr. Bryant noted:

- Premium rates: this is not bargained for in a contract. The benefit amount is unrelated to the premium rates. Congress approves premium rates. Even if the PBGC does not receive payment, the benefit is paid if the plan is an eligible defined benefit plan.
- Not true underwriting as it is not a bargained for transaction, simply a legislatively mandated benefit.

Ms. Payne asked for confirmation that ERISA does not apply to state and local governments.

PBGC said no, ERISA Title IV applies solely to private sector defined benefit plans.

Ms. Gilliam asked if PBGC received any appropriations to fund their programs, salaries and expenses.

PBGC said no, all funding came from sponsor premiums.

Ms. Gilliam turned the discussion to the specific questions concerning FASB's proposed insurance contract standard (Topic 834), specifically why PBGC does not believe they meet the FASB proposed definition. Specifically reading: "A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or its designated beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder," stating that in her view PBGC could possibly fit into this definition. PBGC disagreed with that assessment because PBGC is "scoped-out" of the FASB definition of an insurance contract in the ED, i.e., PBGC does not issue bona fide "bargained for"

⁸ November 6, 2013, PGBC press release: <http://www.pbgc.gov/about/who-we-are/retirement-matters/post/2013/11/06/PBGCs-Yearly-Max-Jumps-in-2014.aspx>

insurance contracts where the level of insurance premiums equates to a given insurance benefit.

Mr. Bryant further noted that there was no reason to analyze the FASB definition of an insurance contract since PBGC was exempt from following the standard as stated in FASB Topic/section 834-10-15-5 subsection b, “the Exposure Draft scopes out certain types of contracts, such as an “employer’s assets and liabilities under employee benefit plans (see Topic 715 retirement benefits) and retirement benefit obligations reported by defined benefit retirement plans (see Topic 960 on defined benefit pension plans)”, which PBGC administers. PBGC properly values, accounts and discloses its financial assets and liabilities consistent with ASC 960, Plan Accounting - Defined Benefit Pension Plans. For this reason, we believe that PBGC is scoped out of the implementation of the Exposure Draft on Insurance Contracts (Topic 834) as it is currently written.”⁹

Mr. Winter noted: PBGC has long maintained that it has a very unique hybrid business model that draws upon a wide range of accounting guidance typically associated with defined benefit pension plans (e.g., ASC section 960) and financial services - investment companies (e.g., ASC 946). PBGC further explained that this unique business model view has been accepted by its three different external auditors over the 21 consecutive years of an “unqualified” unmodified audit opinion on its financial statements and related footnotes. These auditors include GAO who performed the audit the first several years of this time span, followed by PriceWaterhouseCoopers for an extended period, and most recently by CliftonLarsonAllen.

Ms. Gilliam asked at what point does PBGC report plans as a liability using FASB Accounting Standards Codification (ACS) 450, Contingencies.

Mr. Winter explained that there are 10 or so different elements/criteria that determine if a plan is to be classified as a probable and that they are described in detail in PBGC’s Note 2, Significant Accounting Policies, Present Value of Future Benefits (see page 63 of Fiscal Year 2013 Annual Report). Likewise he also noted that the reasonably possible exposure estimate for both insurance programs are described in Note 1, Organization and Purpose, Single-Employer (annual estimate of total underfunding) and Multiemployer (annual estimate of multiemployer plans that may require financial assistance) Program Exposure (see page 58 of Fiscal Year 2013 Annual Report). PBGC has reported probables and reasonably possibles under the FASB ASC 450, Contingencies (as well as predecessor FAS 5), beginning with the GAO’s first unqualified audit opinion for PBGC 21 years ago.

Ms. Gilliam asked when a plan would move to reporting under the FASB ASC 960, Plan Accounting—Defined Benefit Pension Plans?

⁹ Verbatim from original response from October 30, 2013, PBGC letter (see page 2 above).

Mr. Winter/Mr. Bryant answered that PBGC would value financial assets at estimated fair value, consistent with the standards for pension plans contained in FASB ASC 960. Also, pursuant to FASB ASC 960, PBGC values its liabilities for the present value of future benefits and present value of nonrecoverable future financial assistance using assumptions derived from market-based (fair value) annuity prices from insurance companies, as described in PBGC's Fiscal Year 2013 Annual Report, Statement of Actuarial Opinion.

Ms. Gilliam asked if the valuation can change from the ASC 450 to the ASC 960 reporting.

Mr. Winter answered that yes, the valuation at the date of plan termination can change due to new information available at the time of the termination that did not exist in prior valuations. Changes in the plan assets, estimated recoveries or present value of future benefits will either increase or decrease the Losses from completed and probable terminations for each new Fiscal Year.

Mr. Winter added that PBGC typically takes a more conservative, i.e., more of a solvency assessment utilizing typically lower interest factors, than an ongoing plan where the focus is much different and typically relies upon more optimistic, i.e., higher discount factors than those relied on by PBGC. Consequently, the valuations of an ongoing plan can be much different than the solvency based valuations performed by PBGC at the subsequent date of plan termination.

Ms. Payne asked that, if at the point of plan termination, does PBGC become the plan manager, and Ms. Gilliam made the related statement that PBGC could be viewed as the plan trustee. Mr. Winter/Mr. Bryant explained that PBGC's unique business model does not fall within a single category or role. Rather, PBGC acts as the guarantor of the legislatively guaranteed benefits. And, that there can be long intervals of time, typically several years, between reasonably possible plans becoming probable, probable plans becoming terminated and terminated plans becoming trustee. Further, insolvent multiemployer plans receive financial assistance loans per ERISA and are not trustee (except for 10 small multiemployer plans that were trustee in the early 1980s and not since).

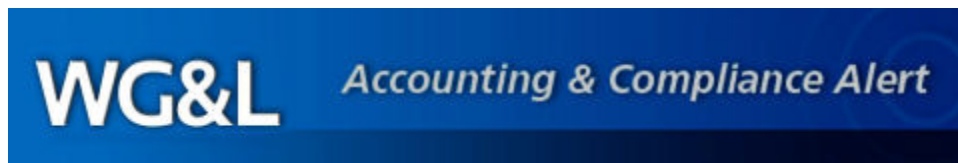
Ms. Payne/Ms. Gilliam said that they noticed in working with the federal insurance FASB Reporters that CliftonLarsonAllen was the auditor for most of them. While FASAB realizes that CliftonLarsonAllen will probably not disclose any specific information about their clients, did PBGC mind FASAB reaching out to them; and, do they know who their expert on insurance is?

Mr. Winter said that PBGC does not know who the CliftonLarsonAllen "insurance expert" is and suggested that FASAB should reach out directly to CliftonLarsonAllen, under contract with the Office of Inspector General.

Ms. Gilliam thanked everyone for meeting with FASAB and closed the meeting.

TAB F – Attachment 4:

December 3, 2013, FASB News: Insurers, Analysts Take Cautious Stance on Insurance Proposal



Tuesday, December 03, 2013

Volume 7, No. 233

ISSN 1935-9721

Today's News

FASB News

Insurers, Analysts Take Cautious Stance on Insurance Proposal

Topic(s): FASB, IASB, Specialized Industries, GAAP, Disclosure, Regulated Industries, IFRS, Financial Reporting, Corporate Governance

Summary: *The FASB's insurance accounting project aims to shed light on the liabilities of a complex industry. At a public roundtable, many preparers, analysts, and auditors said the proposed changes for life insurers won't simplify their accounting but instead introduce too much volatility to their financial statements.*

Life insurers, auditors, and some securities analysts on December 2, 2013, expressed concerns about the FASB's plan to overhaul accounting for insurance liabilities, saying the plan was too complex and would introduce false volatility to insurer financial statements.

The participants in a roundtable at the FASB's headquarters in Norwalk, CT, agreed that accounting for insurance contracts needed a change, but questioned the path the FASB

chose with the June release of Proposed Accounting Standards Update (ASU) No. 2013-290, *Insurance Contracts (Topic 834.)*

The proposal attempts to address a long-running criticism that analyzing insurer liabilities is like looking at a “black box.” Low interest rates that have slashed returns on insurers' investments and market volatility have heightened the calls for reforming how insurers record liabilities—the payments they expect to make to customers.

The FASB plan calls on insurers to make updated assumptions about their liabilities every reporting period and report the effects of those changes in their income statements.

Insurers would be required to assess the time value of money, meaning companies must use a common financial calculation called discounting, which helps assess the value of future payouts in current dollars. To ensure that their calculations are correct, the insurers would update the discount rate every period.

Many insurers, particularly life insurance companies, have expressed concerns about the volatility this would introduce to their financial statements, with up-and-down swings needlessly turning off investors.

Much of the debate at the roundtable focused on this potential volatility.

“What this proposal would do is actually go too far and give us too many short-term updates from an analyst perspective, making analyzing insurance companies far more difficult,” said Alex Obaza, a credit analyst at T. Rowe Price Trust Co.

Angie Sanders, senior vice president and controller at Principal Financial Group, said the proposal would introduce too much noise in insurer financial statements.

“Some folks would criticize current GAAP because it's not sensitive enough,” Sanders said. “But what we’re doing with this new model is making it too sensitive.”

Alan Zimmerman, global financial research coordinator at Macquarie Securities, was one of the few people to voice support about the proposal's most controversial requirements, saying that he believed the changes capture the way insurers make money.

“I'm not uncomfortable with volatility,” he said. “I actually think the volatility reflects the underlying economics.”

U.S. GAAP has had several different insurance accounting standards in place for decades. The standards have been developed over the years to deal with new types of insurance products, and the introduction of each standard has introduced a new accounting method.

The FASB's proposal whittles down the accounting methods to two—one for long-term contracts such as life insurance and another for short-term contracts such as theft and automobile policies.

In addition to discounting, the roundtable also covered the proposed standard's disclosure requirements and the transition to its adoption. Some companies and analysts expressed concerns about the volume of disclosures the proposal asks for.

"I'm sure there's some valuable information in there, but... you're just going to kill analysts with the amount of paperwork we have to deal with," Obaza said.

On transition, the FASB requires businesses to restate past financial results using the new, proposed accounting, in what is called retrospective adoption. Investors usually favor this method because it allows them the ability to accurately compare current and past financial performance. Companies usually say this method will take significant time and effort.

As expected, analysts and businesses expressed different views at the roundtable.

"This is by far the most important part of the whole new model because how a company sets transition is going to affect earnings for a decade," Zimmerman said.

Yves Pinkowitz, president of Pacific Life Insurance Co., said he believed his company would spend \$10 million to make the transition to the new standard because it would need to hire new employees and engage with its auditors more often.

Although international convergence wasn't on the discussion agenda, many participants said they wanted the FASB to converge with the IASB, which has proposed a separate standard for insurance contracts. The two boards had been working together until 2012, when they decided that they were too far apart to come up with a joint standard.

If the FASB can't converge with the IASB, it should pursue limited improvements to U.S. GAAP instead of forging ahead with an overhaul that does not please everyone, said Michael Monahan, senior director of accounting policy at the American Council of Life Insurers.

"If the boards are not going to converge, especially in the U.S., you're going to see a lot of pressure on targeted improvements," Monahan said.

As for next steps, the FASB's research team said it was continuing to conduct field tests on the proposal, and it planned to begin the next round of discussions for the project in January.

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Today's News

FASB News

Insurers, Analysts Take Cautious Stance on Insurance Proposal (December 3, 2013)

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TAB F – Appendices

(Optional Reading for Reference)

Risk Assumed: Insurance and Guarantees

#	Appendix	Page
1	Risk Assumed - Project Decision History	2
2	Federal Insurance Summary Factsheets	3
3	FISCAL EXPOSURES - Improving Cost Recognition in the Federal Budget	40

TAB F - Appendix 1:

Risk Assumed - Project Decision History

June 2013:

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.

February 2013:

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

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

TAB F – Appendix 2:

Federal Insurance Summary Factsheets¹

Federal Insurance FASB GAAP Reporter	Page
Federal Deposit Insurance Corporation (FDIC)	4
Pension Benefit Guarantee Corporation (PBGC)	10
Farm Credit System Insurance Corporation (FCSIC)	19
Overseas Private Investment Corporation (OPIC)	31

¹ Federal Insurance Summary Factsheets for 2012 financial statements were provided previously for the June 2013 – TAB A Meeting attachments. The PGBC factsheet has been updated with their 2013 Financial Statements which were just issued.

DEPOSIT INSURANCE FUND

FEDERAL DEPOSIT INSURANCE CORPORATION

WWW.FDIC.GOV

BRIEF SUMMARY OF PROGRAM

The Federal Deposit Insurance Corporation (FDIC) is the independent deposit insurance agency created by Congress in 1933 to maintain stability and public confidence in the nation's banking system. Provisions that govern the operations of the FDIC are generally found in the Federal Deposit Insurance (FDI) Act, as amended (12 U.S.C. 1811, et seq). In carrying out the purposes of the FDI Act, the FDIC, as administrator of the Deposit Insurance Fund (DIF), insures the deposits of banks and savings associations (insured depository institutions).

“Deposit insurance is essentially about making people feel secure about putting their money into financial institutions.” – 2011 FDIC Annual Report

FDIC's mission is 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.

In cooperation with other federal and state agencies, the FDIC promotes the safety and soundness of insured depository institutions by identifying, monitoring and addressing risks to the DIF. Commercial banks, savings banks and savings associations (known as “thrifts”) are supervised by either the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve Board. In addition, the FDIC, through administration of the Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund (FRF), is responsible for the sale of remaining assets and satisfaction of liabilities associated with the former FSLIC and the former Resolution Trust Corporation (RTC). The DIF and the FRF are maintained separately by the FDIC to support their respective mandates.²

RELATED LEGISLATION AND U.S. CODE (U.S.C.)

1. Banking Act of 1933
2. Banking Act of 1935
3. Federal Deposit Insurance Act of 1950
4. Depository Institutions Deregulation and Monetary Control Act of 1980
5. Financial Institution Reform, Recovery, and Enforcement Act (FIRREA) in 1989

² More information on the FDIC is available online at <http://fdic.gov/about/>; last accessed June 5, 2012.

6. Federal Deposit Insurance Corporation Improvement Act (FDICIA) in 1991
7. Omnibus Budget Reconciliation Act of 1993
8. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994
9. Deposit Insurance Funds Act of 1996 (Funds Act)
10. The Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (collectively, “the Reform Act”)
11. Dodd-Frank Wall Street Reform and Consumer Protection Act (2010)
12. 12 U.S.C. § 1811-1835a

SOURCES OF FINANCING

FDIC receives no Congressional appropriations. It is funded by insurance premiums on deposits held by insured banks and savings associations and from interest on the investment of those premiums in U.S. Government securities. FDIC has authority to borrow up to \$100 billion from the Treasury for insurance purposes.³

SOURCE OF GAAP

FDIC primarily applies generally accepted accounting principles (GAAP) issued by the Financial Accounting Standards Board (FASB). This practice is permitted by paragraph 9 of Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

³ Source: 2012 U.S. Government Manual available online at <http://www.gpo.gov/fdsys/browse/collection.action?collectionCode=GOVMAN&browsePath=2012+Edition+%28December%29%3BGOVMAN-2012-12-07%3Bthumbnails%5C%2Fgovman11-12.jpg&isCollapsed=false&leafLevelBrowse=false&ycord=0> ; last accessed June 5, 2013.

SIGNIFICANT FINANCIAL STATEMENT ELEMENTS⁴

Excerpt from FY 2012 FDIC Annual Report

DEPOSIT INSURANCE FUND (DIF)		
FEDERAL DEPOSIT INSURANCE CORPORATION		
DEPOSIT INSURANCE FUND BALANCE SHEET AT DECEMBER 31		
Dollars in Thousands		
	2012	2011
Assets		
Cash and cash equivalents	\$3,100,361	\$3,277,839
Cash and investments - restricted - systemic risk (Note 16) (Includes cash/cash equivalents of \$0 at December 31, 2012 and \$1,627,073 at December 31, 2011)	0	4,827,319
Investment in U.S. Treasury obligations, net (Note 3)	34,868,688	33,863,245
Trust preferred securities (Note 5)	2,263,983	2,213,231
Assessments receivable, net (Note 9)	1,006,852	282,247
Receivables and other assets - systemic risk (Note 16)	0	1,948,151
Interest receivable on investments and other assets, net	433,592	488,179
Receivables from resolutions, net (Note 4)	23,119,554	28,548,396
Property and equipment, net (Note 6)	392,880	401,915
Total Assets	\$65,185,910	\$75,850,522
Liabilities		
Accounts payable and other liabilities	\$349,620	\$374,164
Unearned revenue - prepaid assessments (Note 9)	1,576,417	17,399,828
Refunds of prepaid assessments (Note 9)	5,675,199	0
Liabilities due to resolutions (Note 7)	21,173,785	32,790,512
Debt Guarantee Program liabilities - systemic risk (Note 16)	0	117,027
Deferred revenue - systemic risk (Note 16)	0	6,639,954
Postretirement benefit liability (Note 13)	224,225	187,968
<i>Contingent liabilities for:</i>		
Anticipated failure of insured institutions (Note 8)	3,220,697	6,511,321
Systemic risk (Note 16)	0	2,216
Litigation losses (Note 8)	8,200	1,000
Total Liabilities	32,228,143	64,023,990
<i>Commitments and off-balance-sheet exposure (Note 14)</i>		
Fund Balance		
Accumulated Net Income	32,682,237	11,560,990
Accumulated Other Comprehensive Income		
Unrealized gain on U.S. Treasury investments, net (Note 3)	33,819	47,697
Unrealized postretirement benefit loss (Note 13)	(60,448)	(33,562)
Unrealized gain on trust preferred securities (Note 5)	302,159	251,407
Total Accumulated Other Comprehensive Income	275,530	265,542
Total Fund Balance	32,957,767	11,826,532
Total Liabilities and Fund Balance	\$65,185,910	\$75,850,522

The accompanying notes are an integral part of these financial statements.

⁴ Source: FDIC website -- <http://www.fdic.gov/about/strategic/report/index.html> last accessed on June 5, 2013.

DEPOSIT INSURANCE FUND (DIF)		
FEDERAL DEPOSIT INSURANCE CORPORATION DEPOSIT INSURANCE FUND STATEMENT OF INCOME AND FUND BALANCE FOR THE YEARS ENDED DECEMBER 31 Dollars in Thousands		
	2012	2011
Revenue		
Assessments (Note 9)	\$12,397,022	\$13,498,587
Interest on U.S. Treasury obligations	159,214	127,621
Systemic risk revenue (Note 16)	(161,135)	(131,141)
Other revenue (Note 10)	6,127,211	2,846,929
Total Revenue	18,522,312	16,341,996
Expenses and Losses		
Operating expenses (Note 11)	1,777,513	1,625,351
Systemic risk expenses (Note 16)	(161,135)	(131,141)
Provision for insurance losses (Note 12)	(4,222,595)	(4,413,629)
Insurance and other expenses	7,282	3,996
Total Expenses and Losses	(2,598,935)	(2,915,423)
Net Income	21,121,247	19,257,419
Other Comprehensive Income		
Unrealized (loss) gain on U.S. Treasury investments, net	(13,878)	20,999
Unrealized postretirement benefit loss (Note 13)	(26,886)	(15,059)
Unrealized gain (loss) on trust preferred securities (Note 5)	50,752	(84,587)
Total Other Comprehensive Income (Loss)	9,988	(78,647)
Comprehensive Income	21,131,235	19,178,772
Fund Balance - Beginning	11,826,532	(7,352,240)
Fund Balance - Ending	\$32,957,767	\$11,826,532
The accompanying notes are an integral part of these financial statements.		

RELEVANT GAO REPORTS (LAST 5 YEARS)

- Opportunities for Improvements in FDIC's Shared Loss Estimation Process ([GAO-12-752R](#), July 19, 2012)
- Federal Deposit Insurance Corporation Funds' 2011 and 2010 Financial Statements ([GAO-12-416](#), Apr 19, 2012)
- FEDERAL DEPOSIT INSURANCE ACT Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify the Provision ([GAO-10-100](#), April 15, 2010)
- Assessment of Regulators' Use of Prompt Corrective Action Provisions and FDIC's New Deposit Insurance System ([GAO-07-242](#), February 15, 2007)

RELATED DISCLOSURES IN CFR

Excerpt from 2012 CFR Note 18: Insurance and Guarantee Program Liabilities

Note 18. Insurance and Guarantee Program Liabilities

Insurance and Guarantee Program Liabilities as of September 30, 2012, and 2011

(In billions of dollars)	2012	2011
Insurance and Guarantee Program Liabilities:		
Pension Benefit Guaranty Corporation - Benefit Pension Plans	105.6	93.0
Federal Deposit Insurance Corporation Funds	26.5	47.4
All other insurance and guarantee programs	24.3	21.3
Total insurance and guarantee program liabilities.....	<u>156.4</u>	<u>161.7</u>

PBGC insures pension benefits for participants in covered defined benefit pension plans. As a wholly-owned corporation of the U.S. Government, PBGC's financial activity and balances are included in the consolidated financial statements of the U.S. Government. However, under current law, PBGC's liabilities may be paid only from PBGC's assets and not from the General Fund of the Treasury or assets of the Government in general. As of September 30, 2012, and 2011, PBGC had total liabilities of \$119.2 billion and \$106.7 billion, and its total liabilities exceeded its total assets by \$34.4 billion and \$26.0 billion, respectively. In addition, as discussed in Note 22—Contingencies, PBGC reported reasonably possible contingent losses of about \$321.8 billion and \$250.2 billion as of September 30, 2012, and 2011, respectively. Of the total FDIC amount as of September 30, 2012, and 2011, \$3.6 billion and \$7.2 billion, respectively, represents the recorded contingent liability and loss provision for institutions insured by the Deposit Insurance Fund that are likely to fail. In addition, \$21.2 billion and \$31.5 billion pertain to liabilities due to resolutions of failed or failing institutions and to pending depositor claims as of September 30, 2012, and 2011 respectively. Another \$1.7 billion and \$8.2 billion as of September 30, 2012, and 2011 respectively, pertains to the Temporary Liquidity Guarantee Program, which guarantees certain newly issued debt and certain noninterest-bearing transaction accounts in an effort to counter the system-wide crisis in the nation's financial sector. The remaining amounts represent contingent liabilities for litigation.

Of the \$24.3 billion and \$21.3 billion under all other insurance and guarantee programs as of September 30, 2012, and 2011, respectively, \$20.0 billion and \$10.3 billion, respectively, pertain to the USDA's Federal Crop Insurance Program. The increase in the estimated indemnities is due to the most severe drought in the farm belt since 1988. The Federal Crop Insurance Program is administered by the Federal Crop Insurance Corporation, whose mission is to provide an actuarially sound risk management program to reduce agricultural producers' economic losses due to natural disasters. Also, \$3.4 billion and \$7.4 billion relates to the National Credit Union Administration's Temporary Corporate Credit Union Stabilization Fund as of September 30, 2012, and 2011, respectively. This Program guarantees the timely payment of principal and interest on certain unsecured debt of participating credit unions.

Excerpt from 2012 CFR Note 22: Contingencies

Insurance Contingencies

At the time an insurance policy is issued, a contingency arises. The contingency is the risk of loss assumed by the insurer, that is, the risk of loss from events that may occur during the term of the policy. The Government has insurance contingencies that are reasonably possible in the amount of \$329.0 billion as of September 30, 2012, and \$267.0 billion as of September 30, 2011. The major programs are identified below:

- PBGC reported \$321.8 billion and \$250.2 billion as of September 30, 2012, and 2011, respectively, for the estimated aggregate unfunded vested benefits exposure to the PBGC for private-sector single-employer and multiemployer defined benefit pension plans that are classified as a reasonably possible exposure to loss.
- FDIC reported \$6.9 billion and \$16.5 billion as of September 30, 2012, and 2011, respectively, for identified additional risk in the financial services industry that could result in additional loss to the Deposit Insurance Fund should potentially vulnerable insured institutions ultimately fail. Actual losses, if any, will largely depend on future economic and market conditions.

PENSION BENEFIT INSURANCE

PENSION BENEFIT GUARANTY CORPORATION

www.PBGC.gov

BRIEF SUMMARY OF PROGRAM

The Pension Benefit Guaranty Corporation (PBGC or the Corporation) is a federal corporation established under the Employee Retirement Income Security Act (ERISA) of 1974, as amended. It guarantees payment of basic pension benefits earned by more than 42 million of America's workers and retirees participating in nearly 25,000 private-sector defined benefit pension plans. The Corporation receives no funds from general tax revenues. Operations are financed by insurance premiums set by Congress and paid by sponsors of defined benefit plans, investment income, assets from pension plans trusted by PBGC, and recoveries from the companies formerly responsible for the plans.

RELATED LEGISLATION AND U.S. CODE (U.S.C.)

1. The Employee Retirement Income Security Act of 1974
2. The Pension Protection Act of 2006

SOURCES OF FINANCING

PBGC is not funded by general tax revenues. PBGC collects insurance premiums from employers that sponsor insured pension plans, earns money from investments and receives funds from pension plans it takes over.

SOURCE OF GAAP

PBGC primarily applies generally accepted accounting principles (GAAP) issued by the Financial Accounting Standards Board (FASB). This practice is permitted by paragraph 9 of Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

SIGNIFICANT FINANCIAL STATEMENT ELEMENTS⁵

Excerpts from FY 2013 PBGC Annual Report

⁵ Source: PBGC website -<http://www.pbgc.gov/res/reports/ar2013.html?CID=CPAD07ACNOV1520131>
Last accessed on November 25, 2013.

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL POSITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
<i>(Dollars in Millions)</i>	September 30, 2013	2012	September 30, 2013	2012	September 30, 2013	2012
ASSETS						
Cash and cash equivalents	\$4,303	\$ 3,782	\$74	\$ 25	\$4,377	\$ 3,807
Securities lending collateral (Notes 3 and 5)	3,322	3,425	-	-	3,322	3,425
Investments, at market (Notes 3 and 5):						
Fixed maturity securities	47,196	48,950	1,632	1,767	48,828	50,717
Equity securities	22,317	21,463	-	-	22,317	21,463
Private equity	1,228	1,339	-	-	1,228	1,339
Real estate and real estate investment trusts	2,373	878	-	-	2,373	878
Other	28	77	-	-	28	77
Total investments	73,142	72,707	1,632	1,767	74,774	74,474
Receivables, net:						
Sponsors of terminated plans	60	41	-	-	60	41
Premiums	1,036	1,086	1	1	1,037	1,087
Sale of securities	601	1,353	-	-	601	1,353
Derivative contracts (Note 4)	276	83	-	-	276	83
Investment income	436	452	9	12	445	464
Other	4	4	0	0	4	4
Total receivables	2,413	3,019	10	13	2,423	3,032
Capitalized assets, net	47	40	3	2	50	42
Total assets	\$83,227	\$82,973	\$1,719	\$1,807	\$84,946	\$84,780

The accompanying notes are an integral part of these financial statements.

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF FINANCIAL POSITION

	Single-Employer Program		Multiemployer Program		Memorandum Total	
	September 30,		September 30,		September 30,	
<i>(Dollars in Millions)</i>	2013	2012	2013	2012	2013	2012
LIABILITIES						
Present value of future benefits, net (Note 6):						
Trusteed plans	\$103,125	\$ 103,126	\$0	\$ 1	\$103,125	\$ 103,127
Plans pending termination and trusteeship	1,091	418	-	-	1,091	418
Settlements and judgments	57	56	-	-	57	56
Claims for probable terminations	745	2,035	-	-	745	2,035
Total present value of future benefits, net	105,018	105,635	0	1	105,018	105,636
Present value of nonrecoverable future financial assistance (Note 7):						
Insolvent plans	-	-	1,352	1,388	1,352	1,388
Probable insolvent plans	-	-	8,579	5,622	8,579	5,622
Total present value of nonrecoverable future financial assistance	-	-	9,931	7,010	9,931	7,010
Payables, net:						
Derivative contracts (Note 4):	210	94	-	-	210	94
Due for purchases of securities	1,608	2,557	-	-	1,608	2,557
Payable upon return of securities loaned	3,322	3,425	-	-	3,322	3,425
Unearned premiums	377	328	42	30	419	358
Accounts payable and accrued expenses (Note 8):	73	76	4	3	77	79
Total payables	5,590	6,480	46	33	5,636	6,513
Total liabilities	110,608	112,115	9,977	7,044	120,585	119,159
Net position	(27,381)	(29,142)	(8,258)	(5,237)	(35,639)	(34,379)
Total liabilities and net position	\$83,227	\$ 82,973	\$1,719	\$1,807	\$84,946	\$ 84,780

The accompanying notes are an integral part of these financial statements.

PENSION BENEFIT GUARANTY CORPORATION
STATEMENTS OF CASH FLOWS

For the Years Ended (Dollars in millions)	September 30,		For the Years Ended September 30,		For the Years Ended September 30,	
	2013	2012	2013	2012	2013	2012
OPERATING ACTIVITIES:						
Premium receipts	\$ 3,042	\$ 2,079	\$ 121	\$ 92	\$ 3,163	\$ 2,171
Interest and dividends received	2,310	2,122	61	58	2,371	2,180
Cash received from plans upon trusteeship	24	126	0	0	24	126
Receipts from sponsors/non-sponsors	(1)	114	0	0	(1)	114
Receipts from the missing participant program	7	7	0	0	7	7
Other receipts	0	1	0	0	0	1
Benefit payments – trustee plans	(5,374)	(5,333)	0	0	(5,374)	(5,333)
Financial assistance payments			(89)	(95)	(89)	(95)
Settlements and judgments	0	0	0	0	0	0
Payments for administrative and other expenses	(418)	(413)	(27)	(20)	(445)	(433)
Accrued interest paid on securities purchased	(276)	(234)	(6)	(3)	(282)	(237)
Net cash provided (used) by operating activities (Note 15)	(686)	(1,531)	60	32	(626)	(1,499)
INVESTING ACTIVITIES:						
Proceeds from sales of investments	88,821	77,382	1,398	667	90,219	78,049
Payments for purchases of investments	(87,614)	(77,090)	(1,409)	(679)	(89,023)	(77,769)
Net change in investment of securities lending collateral	(103)	(1,162)	0	0	(103)	(1,162)
Net change in securities lending payable	103	1,162	0	0	103	1,162
Net cash provided (used) by investing activities	1,207	292	(11)	(12)	1,196	280
Net increase (decrease) in cash and cash equivalents	521	(1,239)	49	20	570	(1,219)
Cash and cash equivalents, beginning of year	3,782	5,021	25	5	3,807	5,026
Cash and cash equivalents, end of year	\$ 4,303	\$ 3,782	\$ 74	\$ 25	\$ 4,377	\$ 3,807

The above cash flows are for trustee plans and do not include non-trustee plans. The accompanying notes are an integral part of these financial statements

RELEVANT GAO REPORTS (LAST 5 YEARS)

PRIVATE PENSIONS: Multiemployer Plans and PBGC Face Urgent Challenges
GAO-13-428T, Mar 5, 2013

PENSION BENEFIT GUARANTY CORPORATION: Redesigned Premium Structure Could Better Align Rates with Risk from Plan Sponsors
GAO-13-58, Nov 7, 2012

PENSION BENEFIT GUARANTY CORPORATION: Asset Management Needs Better Stewardship
GAO-11-271, Jun 30, 2011

PENSION BENEFIT GUARANTY CORPORATION: More Strategic Approach to Contracting Still Needed

GAO-11-588, Jun 29, 2011

PENSION BENEFIT GUARANTY CORPORATION: Improvements Needed to Strengthen Governance Structure and Strategic Management

GAO-11-182T, Dec 1, 2010

PENSION BENEFIT GUARANTY CORPORATION : Workers and Retirees Experience Delays and Uncertainty when Underfunded Plans Are Terminated

GAO-10-181T, Oct 29, 2009

PENSION BENEFIT GUARANTY CORPORATION: More Strategic Approach Needed for Processing Complex Plans Prone to Delays and Overpayments

GAO-09-716, Aug 17, 2009

PENSION BENEFIT GUARANTY CORPORATION: Financial Challenges Highlight Need for Improved Governance and Management

GAO-09-702T, May 20, 2009

RELEVANT DISCLOSURES IN AFR

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions may change over time as new information is obtained or subsequent developments occur. Actual results could differ from those estimates.

RECENT ACCOUNTING DEVELOPMENTS

During FY 2012, PBGC implemented FASB Accounting Standards update No. 2011-04, Fair Value Measurement (Topic 820), *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in*

U.S. GAAP and International Financial Reporting Standards (IFRSs). This Update includes disclosure of the valuation techniques to price Level 3 fair value measurements, as well as disclosure of the sensitivity of different inputs into the valuation process. In addition, PBGC implemented FASB Accounting Standards Update No. 2011-03, Transfers and Servicing (Topic 860), *Reconsideration of Effective Control for Repurchase Agreements*. This Update, effective in FY 2012, addresses the rescission of financial reporting disclosure requirements to eliminate the collateral maintenance implementation guidance. See Note 3 for disclosures of Repurchase Agreements.

VALUATION METHOD

A primary objective of PBGC's financial statements is to provide information that is useful in assessing PBGC's present and future ability to ensure that its plan beneficiaries receive benefits when due. Accordingly, **PBGC values its financial assets at estimated fair value, consistent with the standards for pension plans contained in the FASB Accounting Standards Codification Section 960, *Defined Benefit Pension Plans***. PBGC values its liabilities for the present value of future benefits and present value of nonrecoverable future financial assistance using assumptions derived from market-based (fair value) annuity prices from insurance companies, as described in the Statement of Actuarial Opinion. As described in Section 960, the assumptions are "those assumptions that are inherent in the estimated cost at the (valuation) date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits." Also, in accordance with Section 960, PBGC selects assumptions for expected retirement ages and the cost of administrative expenses in accordance with its best estimate of anticipated experience.

The FASB Accounting Standards Codification Section 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value in U.S. GAAP, and expands disclosures about fair value measurements. Section 820 applies to accounting pronouncements that require or permit fair value measurements...

PRESENT VALUE OF FUTURE BENEFITS (PVFB)

The PVFB is the estimated liability for future pension benefits that PBGC is or will be obligated to pay the participants of trustee plans and the net liability for plans pending termination and trusteeship. The PVFB liability (including trustee plans as well as plans pending termination and trusteeship) is stated as the actuarial present value of estimated future benefits less the present value of estimated recoveries from sponsors and members of their controlled group and the assets of plans pending termination and

trusteeship as of the date of the financial statements. PBGC also includes the estimated liabilities attributable to plans classified as probable terminations as a separate line item in the PVFB (net of estimated recoveries and plan assets). PBGC uses assumptions to adjust the value of those future payments to reflect the time value of money (by discounting) and the probability of payment (by means of decrements, such as for death or retirement). PBGC also includes anticipated expenses to settle the benefit obligation in the determination of the PVFB. PBGC's benefit payments to participants reduce the PVFB liability. The values of the PVFB are particularly sensitive to changes in underlying estimates and assumptions. These estimates and assumptions could change and the impact of these changes may be material to PBGC's financial statements (see Note 6).

(1) **Trusted Plans** – represents the present value of future benefit payments less the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans that have terminated and been trusted by PBGC prior to fiscal year-end. Assets are shown separately from liabilities for trusted plans.

(2) **Pending Termination and Trusteeship** – represents the present value of future benefit payments less the plans' net assets (at fair value) anticipated to be received and the present value of expected recoveries (for which a settlement agreement has not been reached with sponsors and members of their controlled group) for plans for which termination action has been initiated and/or completed prior to fiscal year-end. Unlike trusted plans, the liability for plans pending termination and trusteeship is shown net of plan assets.

(3) **Settlements and Judgments** – represents estimated liabilities related to settled litigation.

(4) **Net Claims for Probable Terminations** – **In accordance with the FASB Accounting Standards Codification Section 450, *Contingencies*, PBGC recognizes net claims for probable terminations which represent PBGC's best estimate of the losses, net of plan assets, and the present value of expected recoveries (from sponsors and members of their controlled group) for plans that are likely to terminate in the future.** The PBGC threshold for recognition of net claims for probable termination is \$50 million or more of underfunding. These estimated losses are based on conditions that existed as of PBGC's fiscal year-end.

Management believes it is likely that one or more events subsequent to PBGC's fiscal year-end will occur, confirming the loss. Criteria used for classifying a specific single-employer plan as a probable termination include, but are not limited to, one or more of the following conditions: the plan sponsor is in liquidation or comparable state insolvency proceeding with no known solvent controlled group member; sponsor has filed or intends to file for distress plan termination and the criteria will likely be met; or PBGC is considering the plan for involuntary termination. In addition, management takes into account other economic events and factors in making judgments regarding the classification of a plan as a probable termination. These events and factors may include, but are not limited to: the plan sponsor is in bankruptcy or has indicated that a bankruptcy filing is imminent; the plan sponsor has stated that plan termination is likely; the plan sponsor has received a going concern opinion from its independent auditors; or the plan sponsor is in default under existing credit agreement(s). In addition, a reserve for small unidentified probable losses and incurred but not reported (IBNR) claims is recorded based on an actuarial loss development methodology (ratio method) (see Note 6).

(5) PBGC identifies certain plans as high-risk if the plan sponsor is in Chapter 11 proceedings or the sponsor's senior unsecured debt is rated CCC+/Caa1 or lower by S&P or Moody's respectively. PBGC specifically reviews each plan identified as high-risk and classifies those plans as probable if, based on available evidence, PBGC concludes that plan termination is likely (based on criteria described in (4) above). Otherwise, high-risk plans are classified as reasonably possible.

(6) In accordance with the FASB Accounting Standards Codification Section 450, PBGC's exposure to

losses from plans of companies that are classified as reasonably possible is disclosed in the footnotes. In order for a plan sponsor to be specifically classified as reasonably possible, it must first have \$5 million or more of underfunding, as well as meet additional criteria. Criteria used for classifying a company as reasonably possible include, but are not limited to, one or more of the following conditions: the plan sponsor is in Chapter 11 reorganization; funding waiver pending or outstanding with the Internal Revenue Service; sponsor missed minimum funding contribution; sponsor's bond rating is below-investment-grade for Standard & Poor's (BB+) or Moody's (Ba1); or sponsor has no bond rating but the Dun & Bradstreet Financial Stress Score is below the threshold considered to be investment grade (see Note 9).

NOTE 6: PRESENT VALUE OF FUTURE BENEFITS

The PVFB is the estimated liability for future pension benefits that PBGC is or will be obligated to pay for trustee plans and plans pending termination and trusteeship. For financial statement purposes, the net assets of plans pending termination and trusteeship (including estimated recoveries, assets, and miscellaneous liabilities) are included in the line item "Plans Pending Termination and Trusteeship." The estimated losses on probable future plan terminations are also included in the PVFB. The PVFB liability is stated at the actuarial present value of estimated future benefit payments.

For FY 2013, PBGC used a 20 year select interest factor of 3.25% followed by an ultimate factor of 3.32% for as long as benefits are to be paid. In FY 2012, PBGC used a 25-year select interest factor of 3.28% followed by an ultimate factor of 2.97% for the remaining years. These factors were determined to be those needed (given the mortality assumptions), to continue to match the survey of annuity prices provided by the American Council of Life Insurers (ACLI). Both the interest factor and the length of the select period may vary to produce the best fit with these prices. The prices reflect rates at which, in PBGC's opinion, the liabilities (net of administrative expenses) could be settled in the market at September 30, for the respective year, for single-premium nonparticipating group annuities issued by private insurers. Many factors may affect these rates, including Federal Reserve policy, changing expectations about longevity risk, and competitive market conditions.

For FY 2013, PBGC used the Retirement Plan-2000 Combined Healthy (RP-2000 CH) Male and Female Tables, each set back one year and projected 24 years to 2024 using Scale AA. For September 30, 2012, PBGC used the same table, set back one year and projected 22 years to 2022 using Scale AA. The number of years that PBGC projects the mortality table reflects the number of years from the 2000 base year of the table to the end of the fiscal year (13 years in FY 2013, 12 years in FY 2012) plus PBGC's calculated duration of its liabilities (11 years in FY 2013 and 10 years in FY 2012).

The ACLI survey of annuity prices, when combined with the mortality table, provides the basis for determining the interest factors used in calculating the PVFB. The insurance company prices, when combined with the stronger mortality table, results in a higher interest factor.

The expense reserve factor for administrative expenses beginning with the FY 2007 valuation is 1.37 percent plus additional reserves for cases in which plan asset determinations, participant database audits and actuarial valuations were not yet complete. In addition to the completion of these milestones, PBGC continues to base the reserve on case size, number of participants and time since trusteeship.

PBGC has in place a policy that allows the Corporation to not decrease a final benefit determination that is overstated by \$5 or less. The effect of this policy is carried through to the calculation of the PVFB liability.

The present values of future benefits for trustee multiemployer plans for FY 2013 and FY 2012 reflect the payment of benefits and the changes in interest and mortality assumptions, expected interest and the effect of experience.

The resulting liability represents PBGC's best estimate of the measure of anticipated experience under these programs...

NOTE 9: REASONABLY POSSIBLE CONTINGENCIES

SINGLE-EMPLOYER PLANS

Single-employer plans sponsored by companies whose credit quality is below investment grade pose a greater risk of being terminated. The estimated unfunded vested benefits exposure amounts disclosed below represent PBGC's estimates of the reasonably possible exposure to loss given the inherent uncertainties about these plans. In rare circumstances for certain large companies, the reasonably possible exposure calculation reflects the estimated unfunded guaranteed benefit determination rather than the estimated unfunded vested benefit determination.

In accordance with the **FASB Accounting Standards Codification Section 450, *Contingencies***, PBGC classified a number of these companies as reasonably possible rather than probable terminations, reflecting the sponsors' financial condition and other factors did not indicate that termination of their plans was likely. This classification was done based upon information about the companies as of September 30, 2013...

FARM CREDIT SYSTEM INSURANCE

FARM CREDIT SYSTEM INSURANCE CORPORATION

WWW.FCSIC.GOV

BRIEF SUMMARY OF PROGRAM

The Farm Credit System Insurance Corporation was established by the Agricultural Credit Act of 1987 as an independent U.S. Government controlled corporation. The Corporation's primary purpose is to ensure the timely payment of principal and interest on insured notes, bonds, and other obligations issued on behalf of Farm Credit System banks.⁶ The mission is to: protect investors in insured Farm Credit System obligations and taxpayers through sound administration of the Farm Credit Insurance Fund, exercise its authorities to minimize Insurance Fund loss, and help ensure the future of a permanent system for delivery of credit to agricultural borrowers.

The Farm Credit System Insurance Corporation (FCSIC) insures the timely payment of principal and interest on the debt securities issued jointly by the five Farm Credit System Banks (Systemwide Debt Securities). The Federal Farm Credit Banks Funding Corporation acts as agent for the five banks in issuing and marketing the Systemwide Debt Securities to the public. The Insurance Fund represents the Corporation's equity, the difference between total assets and total liabilities, including insurance obligations. The Insurance Fund is comprised of an unallocated Insurance Fund, assets for which no specific use has been identified or designated, and six allocated Insurance Reserves Accounts (AIRAs). There is one AIRA for each of the five system banks and one account for the Financial Assistance Corporation (FAC) stockholders.

Insurance premiums are assessed with the objective of maintaining the Secure Base Amount (SBA), defined in the Farm Credit Act as 2 percent of aggregate insured obligations reduced by 90 percent of Federally guaranteed loans and investments and 80 percent of State guaranteed loans and investments, assuming the loans are in accrual status and the investments are not permanently impaired. At yearend, any excess funds above the SBA are transferred to the AIRAs and may be subsequently paid to the account holders. The current AIRAs balance is recorded as part of the Insurance Fund and is available to satisfy insurance obligations until the Corporation disburses payments to the account holders.

The Farm Credit Administration is the safety and soundness regulator responsible for the examination, supervision, and regulation of each FCS institution. FCA is an independent agency in the executive branch of the U.S. Government and derives its broad authorities from the Farm Credit Act. These authorities include examination and enforcement authorities similar to those of commercial bank regulators. The U.S. Senate Committee on Agriculture, Nutrition,

⁶ More information on the FCIC is available online at <http://www.fcsic.gov/index.html>; last accessed May 21, 2013.

and Forestry and the U.S. House of Representatives Committee on Agriculture oversee FCSIC, FCA, and the FCS.

“Protecting Investors in Agriculture and Rural America” 2011 Annual Report

RELATED LEGISLATION AND U.S. CODE (U.S.C.)

1. Agricultural Credit Act of 1987
2. Farm Credit Act
3. 55 FR 36610

SOURCES OF FINANCING

The Corporation operates with no appropriated funds. It collects insurance premiums from each System bank that issues insured obligations. These premiums and the income from the Corporation’s investment portfolio provide the funds necessary to fulfill its mission. Investors provide the funds the System lends to agriculture and rural America.⁷

SOURCE OF GAAP

FCSIC primarily applies generally accepted accounting principles (GAAP) issued by the Financial Accounting Standards Board (FASB). This practice is permitted by paragraph 9 of Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

⁷ Source: 2011 FCSIC Annual Report <http://www.fcsic.gov/FCSIC%20Annual%20Reports.html> last accessed May 21, 2013.

SIGNIFICANT FINANCIAL STATEMENT ELEMENTS

Excerpts from FY 2012 FCSIC Annual Report⁸
Farm Credit System Insurance Corporation
Statements of Financial Condition
As of December 31, 2012 and 2011
(Dollars in thousands)

	<u>2012</u>	<u>2011</u>
Assets		
Cash and cash equivalents	\$ 5,079	\$ 1,101
Investments in U.S. Treasury Obligations (Note 3)	3,196,211	3,266,285
Accrued interest receivable	12,667	26,264
Premiums receivable (Note 4)	<u>84,266</u>	<u>98,699</u>
Total assets	<u>\$ 3,298,223</u>	<u>\$ 3,392,349</u>
Liabilities and Insurance Fund		
Accounts payable and accrued expenses (Note 6)	<u>\$ 287</u>	<u>\$ 385</u>
Total liabilities	<u>287</u>	<u>385</u>
Farm Credit Insurance Fund		
Allocated Insurance Reserves Accounts Allocated in 2012	0	221,851
Unallocated Insurance Fund Balance	<u>3,297,936</u>	<u>3,170,113</u>
Total Insurance Fund	<u>3,297,936</u>	<u>3,391,964</u>
Total liabilities and Insurance Fund	<u>\$ 3,298,223</u>	<u>\$ 3,392,349</u>

⁸ Source: FCSIC website -- <http://www.fcsic.gov/index.html> last accessed June 6, 2013.

Farm Credit System Insurance Corporation
Statements of Income and Expenses and Changes in Insurance Fund
For the years ended December 31, 2012 and 2011
(Dollars in thousands)

	<u>2012</u>	<u>2011</u>
Income		
Premiums (Note 4)	\$ 84,298	\$ 97,257
Interest income	46,842	72,616
Total income	<u>131,140</u>	<u>169,873</u>
Expenses		
Administrative operating expenses (Note 6)	3,317	3,255
Total Expenses	<u>3,317</u>	<u>3,255</u>
Net Income	<u>127,823</u>	<u>166,618</u>
Farm Credit Insurance Fund – beginning of year	<u>3,391,964</u>	<u>3,225,346</u>
Payments to AIRAs Accountholders	<u>221,851</u>	<u>0</u>
Farm Credit Insurance Fund – end of year	<u><u>\$ 3,297,936</u></u>	<u><u>\$ 3,391,964</u></u>

RELEVANT GAO REPORTS (LAST 5 YEARS)

None

RELEVANT DISCLOSURES IN AFR

Excerpts from FY 2012 FCSIC Annual Report⁹

Liability for Estimated Insurance Obligations—The liability for estimated insurance obligations is the present value of estimated probable insurance payments to be made in the future based on the Corporation's analysis of economic conditions of insured System banks.

The insured System banks' primary lending markets are borrowers engaged in farming, ranching, and producing or harvesting of aquatic products, and their cooperatives. Financial weaknesses in these market segments and the effect of general market conditions on the System's borrowers could adversely affect the banks' financial condition and profitability. Insured System banks also face risks from changing interest rate environments and the need to maintain ongoing access to financial markets. Adverse changes in the financial condition and profitability of insured System banks resulting from increased levels of credit, financial, or other risks could occur in the future which would have a material effect on the liability for estimated insurance obligations.

The Corporation actively monitors the creditworthiness and financial position of the insured System banks. Management is not aware of any events or circumstances at this time which would require a liability for estimated insurance obligations to be recorded.

⁹ Source: FCSIC website -- <http://www.fcsic.gov/index.html> last accessed June 6, 2013.

The Farm Credit System

Structure and Funding

The Farm Credit System (System or FCS) is a federally chartered network of cooperative lending institutions owned by the agricultural and rural customers it serves, including farmers, ranchers, producers or harvesters of aquatic products, agricultural cooperatives, and farm-related businesses. As of December 31, 2012, the System had four banks and 82 associations. Each of the associations has its own chartered territory and is affiliated with one of the four banks.

Each association receives wholesale funding from its affiliated bank and lends directly to its owner-borrowers, providing a consistent and reliable source of agricultural and rural credit throughout the United States and the Commonwealth of Puerto Rico. CoBank also has nationwide authority to make retail loans to cooperatives and other eligible entities.

The banks obtain funds for their operations primarily through the sale of Federal Farm Credit Banks Consolidated Systemwide debt securities. The banks own and utilize the Federal Farm Credit Banks Funding Corporation to issue Systemwide debt securities in the capital markets. As the fiscal agent for the banks, the Funding Corporation partners with a select group of dealers to market and distribute the securities to investors throughout the world to finance the System's operations.

Combined Farm Credit System Statistics

(Dollars in Billions)

	2012	2011	2010
Insured Debt Outstanding ¹	\$ 197.5	\$ 184.2	\$ 188.3
Production Agriculture:			
Real Estate Mortgage Loans	88.3	80.7	78.0
Production and Intermediate-term Loans	43.9	41.3	40.6
Agribusiness Loans ²	27.1	24.7	29.6
Communication Loans	4.2	3.8	3.6
Energy, Water and Waste Disposal Loans	14.5	11.8	11.5
Rural Residential Real Estate Loans	6.2	5.8	5.5
International Loans	4.7	3.8	4.0
Lease Receivables	2.4	2.1	2.0
Loans to Other Financial Institutions	0.7	0.6	0.5
Cash and Investments	46.9	47.3	46.3
Net Income	4.1	3.9	3.5
Nonperforming Loans as a Percentage of Total Loans	1.4%	1.7%	1.9%

1. Insured debt outstanding is based on System institution Call Report information and reflects the book value of insured debt outstanding, excluding fair value adjustments, plus accrued interest as of December 31, 2012.

2. As of December 31, 2012, agribusiness loans consisted of loans to cooperatives of \$12.8 billion, processing and marketing loans of \$11.5 billion, and farm-related business loans of \$2.8 billion.

Insured and Other Obligations

FCSIC insures Systemwide and consolidated bonds, notes, and other obligations issued by System banks through the Federal Farm Credit Banks Funding Corporation under section 4.2 (c) or (d) of the Farm Credit Act. Figure 1 shows that insured debt outstanding increased by 7.2 percent in 2012 to \$197.5 billion. This is in contrast to a 2.2 percent decrease in insured debt outstanding in 2011.

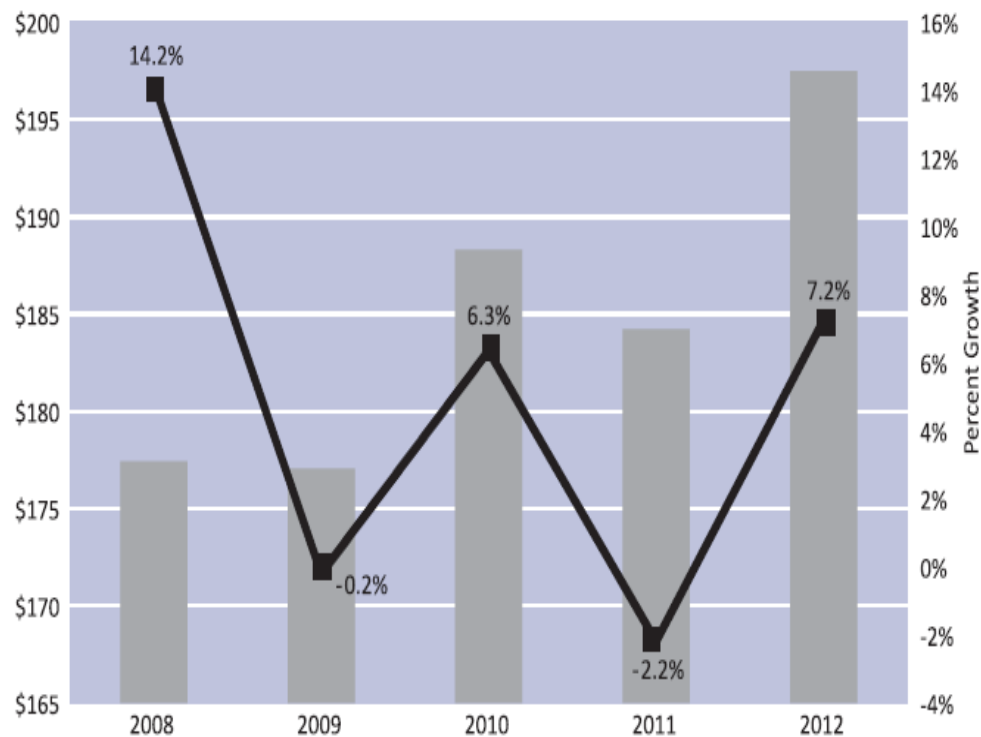
FCSIC must also ensure the retirement of eligible borrower stock at par value, as required by section 4.9A of the Farm Credit Act. This stock, also known as protected borrower stock, was outstanding prior to October 6, 1988. At year-end 2012, protected borrower stock outstanding at System institutions totaled \$2 million, down from \$5 million at year-end 2011.

Figure 1

Insured Debt Outstanding

Growth Averaged 5.1 Percent Over the Past 5 Years

(Dollars in Billions)



Note: Insured debt outstanding is based on System institution Call Report information and reflects the book value of insured debt outstanding, excluding fair value adjustments, plus accrued interest as of December 31, 2012.

Farm Credit System Capital

The primary source of funds to repay insured Systemwide debt securities is the System's borrowers. Each borrower must have a minimum net worth and, in most cases, collateral posted in connection with his or her loan. The borrower makes payments on the loan to the lending bank or association.

The lending association in turn makes payments on its loan to the lending bank. Both the banks, which ultimately repay Systemwide debt securities, and the associations exceed their minimum regulatory capital requirements as protection and support for the repayment of the outstanding insured debt.

If a bank were unable to repay its portion of an insured Systemwide debt obligation, the Corporation would use the Insurance Fund to make that payment. Since the repayment of Systemwide debt securities is the joint and several obligation of the banks, in the event the assets of the Insurance Fund were exhausted, the provisions of joint and several liability of all banks would be triggered, which means the financial resources of the other banks would be used to repay the defaulting bank's portion of the debt issuance.

As figure 2 shows, the amount of FCS bank capital and the balance in the Insurance Fund together increased 41 percent, from \$12.4 billion at year-end 2008 to \$17.5 billion at year-end 2012. Bank capital plus the amount in the Insurance Fund as a percentage of insured debt outstanding decreased from 9.1 percent in 2011 to 8.9 percent in 2012 (see figure 3). Over the past several years, the System banks have reported strong earnings primarily from their ability to re-price debt at favorable rates in the low-interest rate environment. Between 2009 and 2011, the banks retained a significant portion of their earnings to boost capital levels. In 2012, the System's loan growth outpaced its capital growth, causing a slight decline in bank capital as a percentage of insured debt.

Overall, the financial performance and condition of the System on a consolidated basis remains strong, though some individual institutions continue to experience stress from credit deterioration in certain agricultural sectors and from continued stress in the general economy. (See trends in the Financial Institution Rating System in the "Risk Management" section beginning on page 23.)

System associations have boosted capital levels through the net income they have earned and retained. Association capital helps reduce the credit exposure of the association's direct loan with its affiliated bank. As figure 4 shows, from 2008 to 2012, combined association capital increased \$7.4 billion or 38.7 percent, with an annual average increase of approximately 8.6 percent. Since 2008, the associations have collectively achieved solid earnings and preserved capital, causing association capital as a percentage of total assets to steadily increase to 17.8 percent in 2011 and 2012 (see figure 5).

Figure 3

Bank Capital Plus Insurance Fund as Percentage of Insured Debt

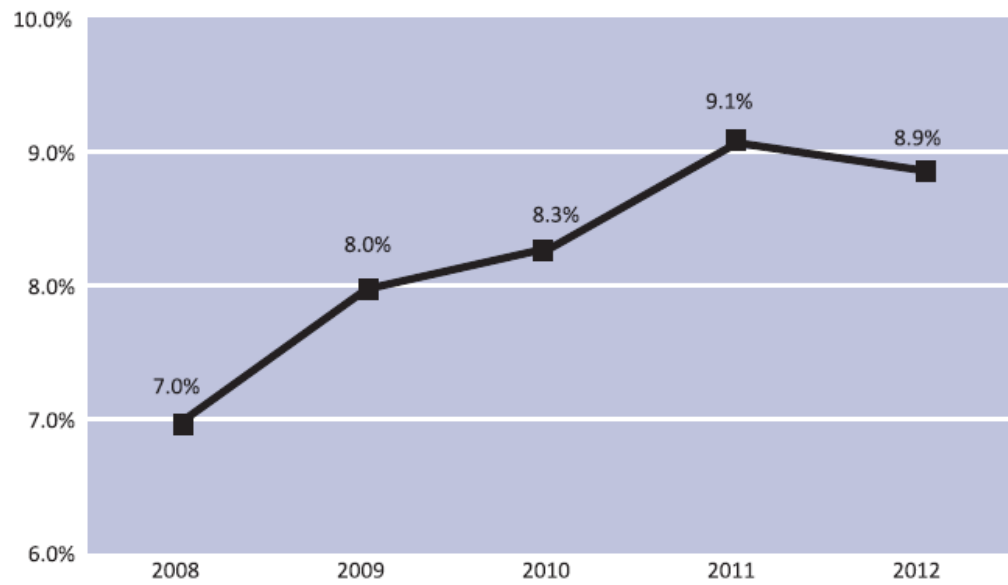
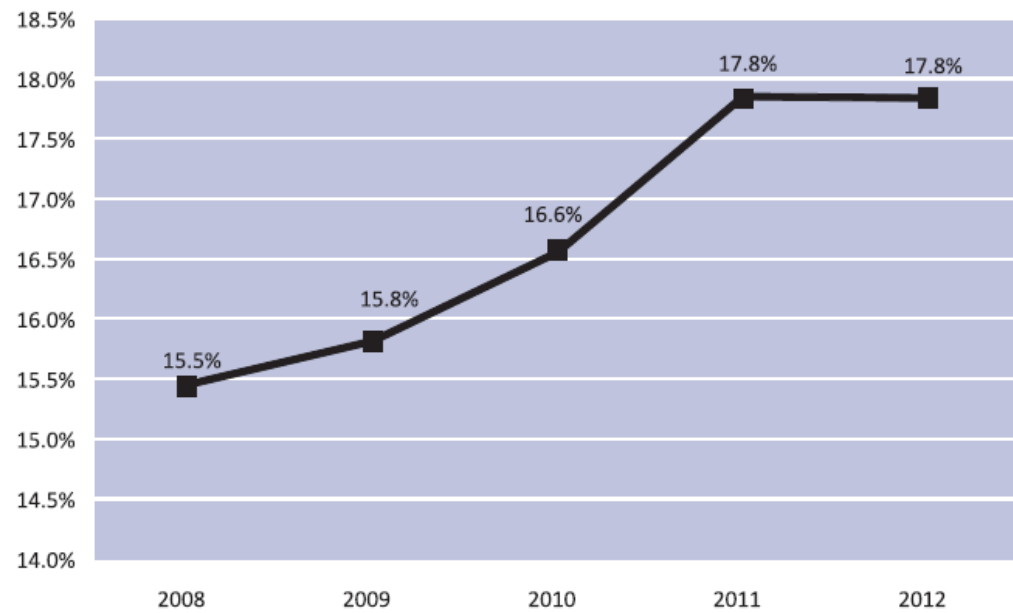


Figure 5

Combined Association Capital as a Percentage of Total Assets



Additional Protections

Farm Credit System banks have additional risk management tools to protect investors. One such tool is the Contractual Interbank Performance Agreement (CIPA). All System banks have entered into this agreement, which measures the financial condition and performance of each bank by using ratios that consider bank capital, asset quality, earnings, interest rate risk, and liquidity. The CIPA financially penalizes banks that do not meet performance standards.

The System and the Federal Farm Credit Banks Funding Corporation have also entered into the Market Access Agreement, which establishes conditions for each bank's continued participation in the debt market. If a bank fails to meet agreed-upon performance measures, including capital and collateral ratios, the bank may be restricted from issuing debt. The criteria used under the Market Access Agreement are the CIPA scores and the net collateral and permanent capital ratios.

The System entered into a common minimum liquidity standard in 2010 to improve the quality and quantity of bank liquidity reserves. This standard is designed to maintain and ensure adequate liquidity to meet the business and financial needs of each bank and the System in the event access to the debt market is temporarily impeded.

In April 2013, the Farm Credit Administration issued a final liquidity rule that strengthens the banks' liquidity reserve requirement, promotes liquidity risk management best practices, and better prepares the banks to withstand a liquidity crisis. For additional information on bank liquidity, see the discussion in the "Risk Management" section of this report.

Insurance Fund Management

The Insurance Fund and the Secure Base Amount

The Farm Credit Insurance Fund represents FCSIC's equity, the difference between total assets and total liabilities, including insurance obligations. The Insurance Fund is composed of an unallocated Insurance Fund (the assets in the Insurance Fund for which no specific use has been identified or designated) and an allocated Insurance Fund (assets transferred to the AIRAs). Premiums are due until the unallocated portion of the Insurance Fund reaches the secure base amount.

The secure base amount established by the Farm Credit Act of 1971, as amended, is 2 percent of the aggregate outstanding insured obligations (adjusted to exclude 90 percent of Federal Government-guaranteed loans and investments and 80 percent of State Government-guaranteed loans and investments), or another percentage that FCSIC determines to be actuarially sound to maintain in the Insurance Fund, taking into account the risk of insuring outstanding insured obligations.

In 2012, both the total Insurance Fund and total assets declined by 2.8 percent to \$3.30 billion as a result of AIRA payments of \$221.9 million. Insured debt outstanding grew \$13.4 billion in 2012 (7.2 percent). The Insurance Fund finished 2012 at 1.93 percent, which was \$119.1 million below the secure base amount (see figure 6). Consequently, no excess funds were available for allocation to the AIRAs at year-end.

At year-end 2011, \$221.9 million, the calculated excess amount in the Insurance Fund, was transferred to the AIRAs. In April 2012, after completion of our year-end audit, the Board of Directors authorized the payment of the \$221.9 million to the account holders. Payments were made in May 2012. (See Note 4 to the Financial Statements for additional details.)

Over the past five years, the total Insurance Fund and total assets each grew at an annual rate of 5.1 percent. We did not accrue a provision for insurance obligations in 2012.

Risk Management

FCSIC monitors and manages insurance risk to minimize the Farm Credit Insurance Fund's exposure to potential losses. Our staff analyzes and evaluates the financial performance and condition of System institutions, maintains continual dialogue with Farm Credit Administration examiners, and reviews reports of examination. When necessary, we request special examinations at System institutions of concern. On a quarterly basis, we screen all System institutions against key performance criteria to identify those institutions that may pose increasing insurance risk.

We also assess risk to the Insurance Fund by

- reviewing corporate actions (such as mergers, restructurings, and other corporate changes) approved by FCA for System institutions;
- monitoring legislative, judicial, regulatory, and economic trends that could adversely affect the agricultural or financial services industries;
- using analytical models; and
- participating as a nonvoting member on FCA's Regulatory Enforcement Committee.

During 2012, risk management staff monitored and evaluated trends and other information affecting agriculture and System institutions, including

- conditions in the global and domestic economy, capital markets, and the agricultural and financial sectors;
- trade policy and Government programs that support U.S. agriculture;
- the effects of commodity price volatility on agricultural operations and farmland values in the Midwest;
- the prolonged effects of the housing crisis on agricultural real estate values in certain regions of the country;
- stress in several farm sectors affecting the quality of System institutions' loan portfolios, including the dairy, swine, poultry, forestry, nursery, and biofuels industries;
- negative trends at specific System institutions with declining Financial Institution Rating System ratings; and
- the performance and condition of the four System banks.

OVERSEAS PRIVATE INVESTMENT

OVERSEAS PRIVATE INVESTMENT CORPORATION (OPIC)

[WWW.OPIC.GOV](http://www.opic.gov)

BRIEF SUMMARY OF PROGRAM

OPIC mobilizes private capital to help solve critical development challenges and in doing so, advances U.S. foreign policy. Because OPIC works with the U.S. private sector, it helps U.S. businesses gain footholds in emerging markets, catalyzing revenues, jobs and growth opportunities both at home and abroad. OPIC achieves its mission by providing investors with financing, guarantees, political risk insurance, and support for private equity investment funds.

Established as an agency of the U.S. Government in 1971, OPIC operates on a self-sustaining basis at no net cost to American taxpayers. OPIC services are available for new and expanding business enterprises in more than 150 countries worldwide. To date, OPIC has supported more than \$200 billion of investment in over 4,000 projects, generated an estimated \$75 billion in U.S. exports and supported more than 277,000 American jobs.¹⁰

Political Risk Insurance

Investing in emerging markets can be unpredictable, even for the most sophisticated investors. While developing markets can offer great opportunity, they can also present a variety of political risks beyond an investor's control. Among them:

- War, civil strife, coups and other acts of politically-motivated violence including terrorism
- Expropriation, including abrogation, repudiation and/or impairment of contract and other improper host government interference
- Restrictions on the conversion and transfer of local-currency earnings

OPIC offers several types of political risk coverage: Currency Inconvertibility, Expropriation, Political Violence and more targeted specialty products.

OPIC political risk insurance is available to U.S. citizens, U.S. firms, or to the foreign subsidiaries of U.S. firms as long as the foreign subsidiary is at least 95%-owned by a U.S. citizen. According to OPIC, such insurance is available for investments in new ventures or in expansions of existing enterprises, and can cover equity investments, parent company and third party loans and loan guarantees, technical assistance agreements, cross-border leases, assigned inventory or equipment, and other forms of investment. This insurance covers three broad areas of political risk: currency inconvertibility, expropriation, and political violence. Currency inconvertibility coverage compensates investors if new currency restrictions are imposed which prevent the conversion and transfer of remittances from insured investments, but it does not protect against currency devaluation.

¹⁰ More information on the OPIC is available online at <http://www.opic.gov> ; last accessed May 29, 2013.

Expropriation coverage protects U.S. firms against the nationalization, confiscation, or expropriation of an enterprise, including actions by foreign governments that deprive an investor of fundamental rights or financial interests in a project for a period of at least six months. This coverage excludes losses that may arise from lawful regulatory or revenue actions by a foreign government and actions instigated or provoked by the investor of foreign firm.

Political violence coverage compensates U.S. citizens and firms for property and income losses directly caused by various kinds of violence, including declared or undeclared wars, hostile actions by national or international forces, civil war, revolution, insurrection, and civil strife (including politically motivated terrorism and sabotage). Income loss insurance protects the investor's share of income from losses that result from damage to the insured property caused by political violence. Assets coverage compensates U.S. citizens and firms for losses of or damage to tangible property caused by political violence. OPIC also has a number of special programs that protect U.S. banks from political violence. This type of insurance reduces risks for banks and other institutional investors, which allows them to play a more active role in financing projects in developing countries. Specialized types of insurance coverage also is available for U.S. investors involved with certain contracting, exporting, licensing, or leasing transactions that are undertaken in a developing country.¹¹

Coverage & Extent of Coverage

Coverage elections for most equity and shareholder debt investments are based on a coverage ceiling and an active amount. The coverage ceiling represents the maximum insurance available for the insured investment and future earnings under an insurance contract. Premiums are calculated based on the active amount, which represents the insurance actually in force during any contract period.

The active amount under all coverages must equal at least the book value of the insured investment unless a lower coverage ceiling is elected. There is no charge for the difference between the coverage ceiling and the active amount.

For most other investment types, premiums are computed based on a maximum insured amount (MIA), a current insured amount (CIA) and a standby amount. The MIA represents the maximum insurance available for the insured investment under an insurance contract. The CIA represents the insurance actually in force during any contract period. The difference between the MIA and CIA is the standby amount. Separate premiums are charged for CIA and standby amounts. For loans, premiums are charged on the "covered amount," the amount of disbursed principal plus accrued interest less principal paid to date, and a standby fee is charged for undisbursed principal.

OPIC insurance contracts generally require that premiums be paid annually in advance. Insurance policies for equity coverage are available for up to 20-year terms. For loans, leases and transactions covered by the contractors and exporters insurance product, the term is generally equal to the duration of the underlying contract or agreement.

¹¹ Source: CRS Report for Congress, 98-567 The Overseas Private Investment Corporation: Background and Legislative Issues

OPIC can insure up to 90 percent of an eligible investment. OPIC's statute generally requires that the investor bear at least 10 percent of the risk of loss. However, loans and capital leases from financial institutions to unrelated third parties may be insured for 100 percent of principal and interest.

For equity investments, OPIC typically issues insurance commitments equal to 270 percent of the initial investment — 90 percent representing the original investment and 180 percent to cover future earnings. Coverage amounts may be limited for investments in countries where OPIC has a high portfolio concentration.

“OPIC’s insurance – combined with our financing options -- allows U.S. businesses to take advantage of commercially attractive opportunities in emerging markets, mitigating risk and helping them compete in a global marketplace. OPIC insurance provides innovative, comprehensive, and cost-effective risk-mitigation products to cover losses to tangible assets, investment value, and earnings that result from political perils.” OPIC’s Website www.opic.gov

RELATED LEGISLATION AND U.S. CODE (U.S.C.)

4. Foreign Assistance Act of 1961 (P.L. 87-195) as amended

SOURCES OF FINANCING

Established as an agency of the U.S. Government in 1971, OPIC operates on a self-sustaining basis at no net cost to American taxpayers. While OPIC is fully self-sustaining from its own revenues, Congress annually provides OPIC with the authority to cover its administrative expenses and credit subsidy funding from its offsetting collections, which include user fees and interest from U.S. Treasury securities. OPIC's budget is composed of noncredit and credit accounts, in conformity with the standards set out in the Federal Credit Reform Act of 1990. The noncredit portion of OPIC's budget relates to OPIC's political risk insurance program, while the credit portion is comprised of OPIC's direct and guaranteed loans. OPIC uses premium income and the interest it accrues from the assets in its noncredit account to fund the direct and indirect expenses in its noncredit and credit accounts. OPIC has a net negative budget authority, as its offsets to budget authority have been greater than its appropriations. For more than thirty years, OPIC has regularly returned “surplus” funds to the U.S. Treasury. Strictly speaking, OPIC's net negative budget authority is not necessarily a “surplus” for the agency. These funds represent a reserve fund against losses that OPIC may accrue through its financing and insurance programs. The surplus may reflect revenues which OPIC has earned (such as through the premiums, interest, and fees generated from OPIC's services), but for which OPIC has not received payment yet. The surplus also may reflect expenses (such as financing, insurance, or investment commitments) that OPIC has incurred but for which OPIC has not yet disbursed payment. The transfer of these funds to the Treasury

essentially is a transaction in the accounting ledger between the Treasury and OPIC, rather than a cash transfer of funds.¹²

SOURCE OF GAAP

OPIC primarily applies generally accepted accounting principles (GAAP) issued by the Financial Accounting Standards Board (FASB). This practice is permitted by paragraph 9 of Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

SIGNIFICANT FINANCIAL STATEMENT ELEMENTS

Excerpt from FY 2012 OPIC Annual Report¹³

¹² Source: CRS Report for Congress, 98-567 The Overseas Private Investment Corporation: Background and Legislative Issues

¹³ Source: OPIC website -- <http://www.opic.gov/media-connections/annual-reports>
last accessed on June 6, 2013.

BALANCE SHEETS

Overseas Private Investment Corporation—Years ended September 30, 2012 and 2011 (\$ in thousands)

Assets	2012	2011
Fund Balance with U.S. Treasury (notes 2 and 4)	\$1,076,559	\$ 707,257
U.S. Treasury securities, at amortized cost plus related receivables (notes 2 and 7)	5,320,325	5,188,527
Direct loans outstanding, net (notes 2 and 10)	1,363,216	1,326,292
Accounts receivable resulting from investment guaranties, net (notes 2 and 11)	42,394	59,602
Assets acquired in insurance claims settlements, net (notes 2 and 11)	1,507	1,507
Guaranty receivable (notes 2 and 19)	692,000	456,130
Accrued interest and fees and other, net (notes 2 and 10)	32,843	29,481
Furniture, equipment and leasehold improvements at cost less accumulated depreciation and amortization of \$17,255 in FY2012 and \$15,742 in FY2011 (note 2)	6,223	6,649
Total assets	<u>\$8,535,067</u>	<u>\$7,775,445</u>
Liabilities, Capital, and Retained Earnings		
Liabilities:		
Reserve for political risk insurance (note 9)	\$278,000	\$275,000
Reserve for investment guaranties (notes 10)	489,320	573,331
Accounts payable and accrued expenses	5,515	4,984
Guaranty liability (notes 2 and 19)	692,000	456,130
Customer deposits and deferred income	52,196	47,465
Borrowings from U.S. Treasury, and related interest (note 6)	2,241,224	1,827,691
Unearned premiums	26,382	8,144
Deferred rent & rent incentives from lessor of \$6,413 and \$5,779 net of accumulated amortization of \$2,660 and \$2,421 in FY2012 and FY2011 (note 14)	3,753	3,358
Total liabilities	<u>3,788,390</u>	<u>3,196,103</u>
Contingent liabilities (notes 2 and 17)		
Capital and retained earnings:		
Contributed capital	50,000	50,000
Credit funding (note 5)	107,484	105,788
Interagency transfers (Note 2)	16,312	16,354
Retained earnings and reserves:		
Insurance (notes 9 and 12)	858,251	790,887
Guaranty (notes 10 and 12)	3,714,630	3,616,313
Total capital and retained earnings	<u>4,746,677</u>	<u>4,579,342</u>
Total liabilities, capital, and retained earnings	<u>\$8,535,067</u>	<u>\$7,775,445</u>

STATEMENTS OF INCOME

Overseas Private Investment Corporation–Years ended September 30, 2012 and 2011 (\$ in thousands)

Revenues	2012	2011
Political risk insurance premiums and fees (note 9)	\$ 15,452	\$ 14,281
Investment financing interest and fees	198,699	218,164
Interest on finance program deposits	36,124	31,059
Interest on U.S. Treasury securities	162,113	170,364
Total revenues	<u>412,388</u>	<u>433,868</u>
Expenses		
Provisions for reserves:		
Political risk insurance (notes 2 and 9)	(23,021)	(9,750)
Investment financing (notes 2, 10 and 11)	4,721	34,720
Salaries and benefits (note 15)	33,320	31,608
Rent, communications and utilities (note 14)	7,005	6,953
Contractual services	19,146	13,596
Travel	4,739	3,949
Interest on borrowings from U.S. Treasury (note 6)	90,547	80,824
Depreciation and amortization (note 2)	1,513	885
Other general and administrative expenses	1,848	1,627
Total expenses	<u>139,818</u>	<u>164,412</u>
Net income	<u>\$272,570</u>	<u>\$269,456</u>

RELEVANT GAO REPORTS (LAST 5 YEARS)

No recent or relevant reports.

DISCLOSURES IN AFR

Excerpt from FY 2012 OPIC Annual Report¹⁴

(2) Summary of Significant Accounting Policies

Reserves for Political Risk Insurance and Investment Guaranties:

The reserves for political risk insurance and investment guaranties provide for losses inherent in those operations using the straight-line method. These reserves are general reserves, available to absorb losses related to the total insurance and guaranties outstanding, which are off-balance-sheet commitments. The reserves are increased by provisions charged to expense and decreased for claims settlements. The provisions for political risk insurance and investment guaranties are based on management's evaluation of the adequacy of the related reserves. This evaluation encompasses consideration of past loss experience, changes in the composition and volume of the insurance and guaranties outstanding, worldwide economic and political conditions, and project-specific risk factors. Also, in the political risk insurance reserve evaluation, OPIC takes into consideration losses incurred but not yet reported.

FASB Accounting Standards Codification Topic 460 for the Guarantee Topic (FASB ASC 460):

FASB ASC 460 requires that upon issuance of a guaranty, the guarantor must disclose and recognize a liability for the fair value of the obligation it assumes under that guaranty. The initial recognition and measurement requirement of FASB ASC 460 applies only to guaranties issued or modified after December 31, 2002. OPIC's initial guarantee obligation reported, represents the fair value of the investment guaranties. This obligation is reduced over the term of the investment guarantee agreements, as OPIC is released from its obligation.

¹⁴ Source: OPIC website -- <http://www.opic.gov/media-connections/annual-reports> last accessed on June 6, 2013.

(9) Political Risk Insurance

Insurance revenues include the following components for the years ended September 30 (dollars in thousands):

	2012	2011
Political risk insurance premiums	\$15,452	14,281
Miscellaneous insurance income	—	—
Total insurance revenue	\$15,452	14,281

OPIC's capital, allowance, retained earnings, and reserves available for insurance totaled \$1.1 billion at both September 30, 2012 and 2011. Charges against retained earnings could arise from (A) outstanding political risk insurance contracts, (B) pending claims under insurance contracts, and guaranties issued in settlement of claims arising under insurance contracts.

single highest coverage amount. Claim payments are limited by the value of the investment and the amount of current coverage in force at the time of the loss and may be reduced by the insured's recoveries from other sources. In addition, in certain contracts, OPIC's requirement to pay up to the single highest coverage amount is further reduced by stop-loss and risk-sharing agreements. Finally, losses on insurance claims may be reduced by recoveries by OPIC as subrogee of the insured's claim against the host government. Payments made under insurance contracts that result in recoverable assets are reported as assets acquired in insurance settlements.

OPIC's Maximum Contingent Liability at September 30, 2012 and 2011 was \$3.1 billion and \$2.6 billion, respectively. This amount is OPIC's estimate of maximum exposure to insurance claims, which includes standby coverage for which OPIC is committed but not currently at risk. A more realistic measure of OPIC's actual exposure to insurance claims is the sum of each single highest "current" coverage for all contracts in force, or Current Exposure to Claims (CEC). OPIC's CEC at September 30, 2012 and 2011 was \$2.4 billion and \$1.7 billion, respectively.

(a) Political Risk Insurance

OPIC insures investments for up to 20 years against three different risks: inconvertibility of currency, expropriation, and political violence. Insurance coverage against inconvertibility protects the investor from increased restrictions on the investor's ability to convert local currency into U.S. dollars. Inconvertibility insurance does not protect against devaluation of a country's currency.

Expropriation coverage provides compensation for losses due to confiscation, nationalization, or other governmental actions that deprive investors of their fundamental rights in the investment.

Insurance against political violence insures investors against losses caused by politically motivated acts of violence (war, revolution, insurrection, or civil strife, including terrorism and sabotage).

Under most OPIC insurance contracts, investors may obtain all three coverages, but claim payments may not exceed the

(b) Pending Claims

At both September 30, 2012 and 2011 OPIC had no material pending insurance claims. In addition to requiring formal applications for claimed compensation, OPIC's contracts generally require investors to notify OPIC promptly of host government action that the investor has reason to believe is or may become a claim. Compliance with this notice provision sometimes results in the filing of notices of events that do not mature into claims.

OPIC does not record a specific liability related to such notices in its financial statements, due to the highly speculative nature of such notices, both as to the likelihood that the events referred to will ripen into any claims, and the amounts of compensation, if any, that may become due. Any claims that might arise from these situations are factored into the reserves for political risk insurance.

Changes in the reserve for political risk insurance during fiscal years 2012 and 2011 were as follows (dollars in thousands):

	2012	2011
Beginning balance	\$275,000	275,000
Amounts charged off	—	—
Increase/(Decrease) in provisions	3,000	29
Transfers (to)/from other reserves	—	(29)
Ending balance	\$278,000	275,000

(16) Concentration of Risk

OPIC is subject to certain risks associated with financial instruments not reflected in its balance sheet. These financial instruments include political risk insurance, loan guaranties, and committed-but-undisbursed direct loans.

With respect to political risk insurance, OPIC insures against currency inconvertibility, expropriation of assets, and political violence. Additionally, OPIC provides investment financing through direct loans and investment guaranties.

OPIC's credit policy is to take a senior security position in the assets of the projects or transactions it guaranties. The nature and recoverable value of the collateral pledged to OPIC varies from transaction to transaction and may include tangible assets, cash collateral or equivalents, and/or a pledge of shares in the project company as well as personal and corporate guaranties. OPIC takes all necessary steps to protect its position in such collateral and retains the ability to enforce its rights as a secured lender if such action becomes necessary.

The following is a summary of OPIC's off-balance-sheet risk at September 30, 2012 and 2011 (dollars in thousands):

	2012		
	Total	Outstanding	Unused Commitments
Guaranties	\$10,022,667	5,437,500	4,585,167
Undisbursed			
direct loans	1,806,812	—	1,806,812
Insurance	3,134,483	2,353,720	780,763

	2011		
	Total	Outstanding	Unused Commitments
Guaranties	\$8,096,076	4,867,358	3,228,718
Undisbursed			
direct loans	2,119,809	—	2,119,809
Insurance	2,595,376	1,662,057	933,319

OPIC's off-balance-sheet finance and insurance exposure involves coverage outside of the United States. The following is a breakdown of such total commitments at September 30, 2012 by major geographical area (dollars in thousands):

	Loan Guaranties	Undisbursed Portion on Direct Loans	Insurance
Africa	\$ 1,969,363	275,813	1,301,259
Asia	1,222,502	291,327	627,815
Europe	1,443,842	37,699	4,027
Latin America	2,533,029	220,099	329,518
Middle East	1,806,158	518,527	868,136
NIS (New Independent States)	625,549	143,397	366,746
Worldwide	422,224	319,950	—
Insurance stop loss adjustment	—	—	(363,018)
	<u>\$10,022,667</u>	<u>1,806,812</u>	<u>3,134,483</u>

OPIC has several client-specific contracts with stop-loss limits that are less than the aggregate coverage amounts. The insurance stop-loss adjustment represents the difference between the aggregate coverage amount and OPIC's actual exposure under these contracts.

At September 30, 2012, OPIC's largest finance and insurance exposure was in the following countries and sectors (dollars in thousands):

Country	
Turkey	\$1,119,229
Jordan	1,077,717
Ghana	834,668
India	728,946
South Africa	628,967

Sector	
Financial services	\$8,143,930
Energy - Power	3,368,243
Services	1,335,353
Energy - Oil and Gas	909,591
Manufacturing	722,594

October 2013

GAO Highlights

Highlights of [GAO-14-28](#), a report to the Chairman, Committee on the Budget, House of Representatives

Why GAO Did This Study

The federal government's long-term fiscal imbalances are driven on the spending side by the effects of an aging population and rising health care costs on Social Security and major federal health programs. However, GAO identified a variety of other fiscal exposures—responsibilities, programs, and activities that may legally commit or create the expectation for future federal spending—that vary as to source, extent of the government's legal commitment, and magnitude. A more complete understanding of these other fiscal exposures can help policymakers anticipate changes in future spending and enhance control and oversight over federal resources.

GAO was asked to provide information on risks facing the federal budget. This report (1) examines selected programs that create a fiscal exposure, including the extent and estimated magnitude of the government's legal commitment; and (2) assesses how fiscal exposures could be better recognized in the budget. Based on its review of budget and financial data, GAO selected nine programs, including federal employee benefit programs, insurance programs, and the stock purchase agreements with Fannie Mae and Freddie Mac, and drew upon previous work to discuss potential approaches for improving budgetary attention to fiscal exposures.

What GAO Recommends

GAO is not making new recommendations but this analysis provides additional support for past recommendations to improve budget recognition of fiscal exposures by, for example, expanding the availability and use of information on expected future spending arising from commitments made today.

View [GAO-14-28](#). For more information, contact Susan J. Irving at (202) 512-6806 or irvings@gao.gov.

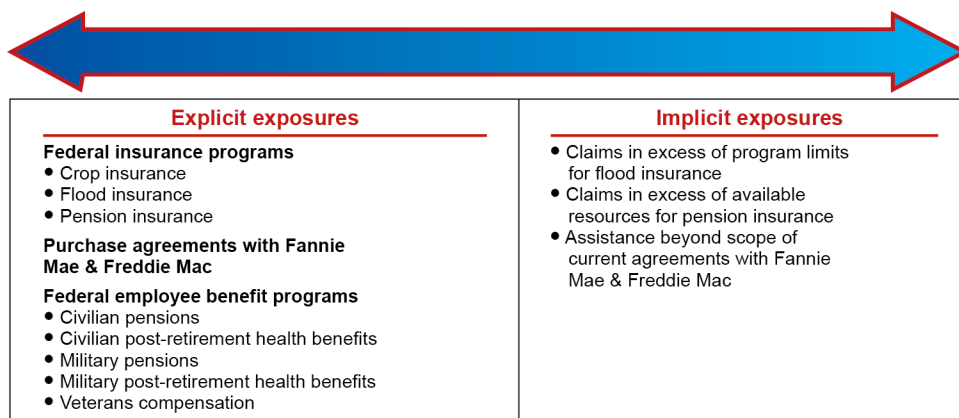
FISCAL EXPOSURES

Improving Cost Recognition in the Federal Budget

What GAO Found

Fiscal exposures may be explicit in that the federal government is legally required to pay for the commitment; alternatively, it may be implicit in that the exposure arises from expectations based on current policy or past practices. The nine programs GAO examined illustrate the range of federal fiscal exposures (see figure) and how they can change over time. Also, some programs may have elements of both explicit and implicit exposure. Federal insurance programs, for example, fall across the spectrum: if an event occurs, some payment is legally required—an explicit exposure. However, there may be an expectation that the government will provide assistance beyond the amount legally required—that is an implicit exposure. Prior to 2008, securities issued by Fannie Mae or Freddie Mac were explicitly not backed by the U.S. government. However, in response to the financial crisis, the government's agreement to provide temporary assistance to cover their losses up to a set amount created a new explicit exposure. The amount of future spending arising from federal fiscal exposures varies in the degree to which it is known and can be measured.

Figure: Selected Programs Illustrate the Range of Fiscal Exposures



Source: GAO.

For some exposures GAO found that the budget provided incomplete information or potentially misleading signals regarding the full cost of the commitments made today. A uniform across-the-board approach to make fiscal exposures more apparent when making budget decisions may not be appropriate given their varying characteristics. Several factors need to be taken into account in selecting an approach to better recognize fiscal exposures in the budget: the extent of the government's legal commitment; the length of time until the resulting payment is made; and the extent to which the magnitude of the exposure can be reasonably estimated. Expanding the availability and use of supplemental information, including measures that can signal significant changes in the magnitude of fiscal exposures, would be an important first step to enhancing oversight over federal resources and can aid in monitoring the financial condition of programs over the longer term. Incorporating measures of the full cost into primary budget data would provide enhanced control over future spending, which can help both improve the nation's fiscal condition and enhance budgetary flexibility.