



BDO BULLETIN

FASB IMPROVES ACCOUNTING FOR LONG-DURATION CONTRACTS

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Editors Note: Accounting Standards Update 2019-09, *Financial Services – Insurance (Topic 944): Effective Date*, (ASU 2019-09) deferred the effective dates of ASU 2018-12. This Bulletin has been updated to reflect the new effective dates.

SUMMARY

The FASB issued ASU 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, (ASU 2018-12) to improve, simplify and enhance the financial reporting of long-duration contracts issued by insurance companies. That is, ASU does not impact noninsurance companies.

BACKGROUND

The FASB issued ASU 2018-12 with the objective of making targeted improvements to the existing recognition, measurement, presentation, and disclosure requirements for long-duration contracts issued by an insurance entity. The changes apply to insurance companies that issue long-duration contracts such as life insurance, disability income, long-term care and annuities. The changes do not apply to policyholders or noninsurance companies.

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MAIN PROVISIONS

The following table was adapted from ASU 2018-12:

AREA	PRIOR TO ASU 2018-12	TARGETED IMPROVEMENTS
Liability for Future Policy Benefits	<p>Original assumptions used to measure the liability for future policy benefits are locked at contract inception and held constant over the term of the contract. The liability includes a provision for risk of adverse deviation, and assumptions are unlocked if a premium deficiency arises.</p> <p>An unobservable discount rate (a rate based on an insurance entity's expected yield on its invested assets) is used to discount future cash flows.</p>	<p>The liability for future policy benefits for nonparticipating traditional and limited-payment contracts will be required to be updated for changes in assumptions. Cash flow assumptions will be reviewed and updated as necessary, at least annually, with changes reflected separately in net income. Discount rate assumptions will be updated each reporting period with changes reflected in other comprehensive income.</p> <p>The liability will be discounted at an upper-medium grade (low-credit-risk) fixed-income instrument yield that reflects the characteristics of the liability rather than the invested assets.</p>
Measurement of Market Risk Benefits	<p>Certain market-based options or guarantees associated with deposit (or account balance) contracts share common risk characteristics that expose an insurance entity to capital market risk. However, there are two different measurement models (a fair value model and an insurance accrual model).</p>	<p>Market risk benefits will be measured using a single measurement model (fair value), with the effect of changes in the insurance entity's credit risk recognized in other comprehensive income.</p>
Deferred Acquisition Costs (DACs)	<p>Multiple amortization methods exist, some of which are complex and require numerous inputs and assumptions.</p>	<p>DACs will be amortized on a constant-level basis over the expected term of the contract. DACs will be written off for unexpected contract terminations but will not be subject to an impairment test.</p>
Disclosures	<p>There are limited requirements to disclose information about long-duration contracts.</p>	<p>Several new disclosures will be required, including liability rollforwards and information about significant inputs, judgments, assumptions and methods used in measurement, and the effect of those changes on measurement.</p>

EFFECTIVE DATES AND TRANSITION

After the issuance of ASU 2019-12, the effective date of ASU 2018-12 is as follows:

- ▶ Public business entities that meet the definition of a Securities and Exchange Commission (SEC) filer, excluding entities eligible to be smaller reporting companies as defined by the SEC, for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years
- ▶ For all other entities, for fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024
- ▶ Early application continues to be allowed.

Changes to the liability for future policy benefits and DACs will apply to all outstanding contracts based on their existing carrying amounts at the beginning of the earliest period presented, subject to certain adjustments. An insurance entity will have the option to apply the changes retrospectively using actual historical experience information as of contract inception. This option will be elected at the contract issue-year level and applied to all contract groups for that issue year and all subsequent issue years. Market risk benefits will be measured at fair value at the beginning of the earliest period presented, with the cumulative effect of the changes in the insurance entity's credit risk recognized in accumulated other comprehensive income, while the difference between fair value and carrying value (excluding the effect of credit risk changes) recognized in the opening balance of retained earnings.