Working Draft

Targeted Improvements to Long-Duration Contracts Implementation Paper

Issue #12: Assumed reinsurance - FASB ASU 2018-12 implementation issues applicable to assumed reinsurance of traditional and limited payment long-duration insurance contracts, specifically, the level of aggregation at which reserves are calculated under ASC 944-40-30-7.

Wording to be Included in the Audit and Accounting Guide: Life and Health Insurance Entities.

Assumed Reinsurance

1. As noted in the paragraph 47 of the basis for conclusions to FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts,* the pre-FASB Codification standard for reinsurance accounting, “an assuming enterprise generally accounts for a reinsurance contract in the same manner as an insurance contract sold to an individual or non-insurance enterprise, as prescribed in Statements 60 and 97” (now ASC 944).

2. Therefore, consistent with the intent of paragraph 47 of the basis for conclusions to FASB Statement No. 113, FinREC believes assumed traditional and limited-payment long-duration reinsurance contracts are subject to the guidance applicable to direct insurance contracts. This includes all of the relevant guidance for the liability for future policy benefits including the ongoing updating of assumptions (unlocking), use of an upper-medium grade fixed-income instrument yield to discount cashflows used to calculate the net premium ratio, and being subject to the guidance relating to the level of aggregation at which reserves are calculated, as described in Chapter XX of this guide.

3. Reinsurers may issue reinsurance contracts that provide coverage for direct insurance contracts that are issued for a period subsequent to the inception date of the reinsurance contract. In addition, reinsurers may provide coverage for different types of cedant products (such as reinsurance of whole life, disability, long term care and universal life insurance) in a single legal reinsurance contract. These situations require judgment in the evaluation to “determine the level of aggregation at which reserves are calculated” (referred to herein as the “cohort”) as required by FASB ASC 944-40-30-7 for its assumed contracts.

4. In practice, assumed reinsurance contracts that provide coverage for direct insurance contracts that are issued for a period subsequent to the inception date of the reinsurance contract are typically recognized as the direct reinsured contracts are issued. Under this approach, the assuming entity is effectively “looking through” the legal contract to the direct reinsured contracts issued by the ceding entity. In accordance with FASB ASC 944-40-30-7, and consistent with how the ceding entity calculates its liability, the assuming entity “shall not group contracts together from

different issue years but shall group contracts into quarterly or annual groups." Therefore, FinREC believes that under this approach an assuming entity's annual grouping limitation should be based upon underlying direct reinsured contract policy issue dates, not the reinsurance contract issue date. When recognizing the assumed reinsurance as the direct reinsured contracts are issued, FinREC believes the discount rate used to calculate the net premium ratio for a cohort should take into consideration the discount rates in effect at the dates that each direct reinsured contract is issued. See additional guidance provided in ASU 2018-12 Implementation Paper #16: *Level of Aggregation for the Measurement of the Liability for Future Policy Benefits*, for additional considerations in determining the cohort and Paper #6: *Discount Rates*, for additional considerations in determining the discount rate.

Comments should be received by April 15, 2021, and sent by electronic mail to Kim Kushmerick at kim.kushmerick@aicpa-cima.com, or you can send them by mail to attention: Kim Kushmerick, 1345 Avenue of the Americas, New York, N.Y., 10105.