Working Draft:

Targeted Improvements to Long-Duration Contracts Implementation Issue

Issue #2: Considerations for the Allocation of the Liability for Future Policy Benefits to Revised Units of Account at Transition to FASB ASU 2018-12, for Blocks of Business that had Loss Recognition Prior to the Transition Date

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

Modified Retrospective Implementation: Carryover Basis Transition for Loss Recognition Blocks

1. Upon adoption of FASB ASU 2018-12, entities are required to measure the liability for future policyholder benefits for traditional long-duration and limited-payment contracts in force as of the transition date using the updated guidance for grouping contracts, which prohibits grouping contracts from different issue years.

2. FASB 944-40-65-2 states,

   The following represents the transition and effective date information related to Accounting Standards Update No. 2018-12, Financial Services – Insurance (Topic 944): *Targeted Improvements to the Accounting for Long-Duration Contracts:*

   c. At the beginning of the earliest period presented (that is, the transition date), an insurance entity shall apply the [guidance] to contracts in force on the basis of their existing carrying amounts at the transition date and by using updated cash flow assumptions, adjusted for the removal of any amounts in accumulated other comprehensive income.

   d. For the liability for future policy benefits:

      2. The present value of future benefits and related expenses less the transition date carrying amount shall be compared with the present value of future gross premiums to calculate the ratio of net premiums to gross premiums.

      5. The transition date shall be considered the revised contract issue date for purposes of subsequent adjustments but not for purposes of contract grouping.

      6. For contracts in force issued before the transition date, an insurance entity shall not group contracts together from different original contract issue years but shall group contracts into

quarterly or annual groups on the basis of original contract issue date for purposes of calculating the liability for future policy benefits. For acquired contracts, the acquisition date shall be considered the original contract issue date.

3. Because of the difference in determining the unit of account between GAAP prior to the adoption of FASB ASU 2018-12 (i.e., entire loss recognition cohort oftentimes spanning multiple issue years and products) and FASB ASU 2018-12 (i.e., prohibition of grouping contracts from different issue years), entities with loss recognition blocks will likely need to disaggregate the blocks to measure the liability at the separate annual (or lower level) cohorts in accordance with FASB ASC 944-40-65-2d(6). In making the determination for cohorts, insurers should consider FASB ASC 944-40-50-5A which requires that "An insurance entity shall aggregate or disaggregate the disclosures in paragraphs 944-40-50-6 through 50-7C so that useful information is not obscured by the inclusion of a large amount of insignificant detail or by the aggregation of items that have significantly different characteristics (see paragraphs 944-40-55-13F through 55-13H)."

4. FASB 944-40-65-2 provides the following implementation guidance for the liability carryover basis at transition,

   k. An insurance entity may have implemented the transition guidance in (c) to all or some contracts in force on the basis of their carrying amounts (adjusted for the removal of any related amounts in accumulated other comprehensive income) at the transition date (that is, the carryover basis) and updated future assumptions. The transition date shall be considered the revised contract issue date for purposes of subsequent adjustments but not for purposes of contract grouping; the original contract issue date shall be used for purposes of contract grouping, and contracts from different original contract issue years shall not be grouped.

5. FinREC believes entities should develop a reasonable allocation process such that the total existing carrying amount at transition (for the entire loss recognition block) is apportioned to the cohorts so they can be measured in accordance with FASB ASC 944-40-65-2d(6), which indicates "for contracts in force issued before the transition date, an insurance entity shall not group contracts together from different original contract issue years but shall group contracts into quarterly or annual groups on the basis of original contract issue date for purposes of calculating the liability for future policy benefits." Depending on the facts and circumstances of the loss recognition block (e.g., age of the block, nature of data available from IT systems, etc.) and timing of the most recent loss recognition event, the detail available to entities regarding the various assumptions will likely be different.

6. FinREC believes a variety of carryover basis allocation methods may be reasonable, provided the allocation methodology is designed such that the sum of the parts equals the whole (i.e., the existing carrying amount for the loss recognition cohort before allocation should equal the total carryover basis used for the respective FASB ASU 2018-12 cohorts), and the revised net premium ratio and subsequent profit emergence is consistent with the underlying economics of the cohorts. FinREC believes that the entity should disclose its allocation methodology if the loss recognition block is material.

7. Once the carryover basis is determined, an entity is required to calculate a revised net premium ratio for each FASB ASU 2018-12 cohort at the transition date based on updated expectations for future cash flows and adjusted for the carryover basis in accordance with FASB ASC 944-40-65-2d(2).

8. In accordance with FASB ASC 944-40-65-2d(3), if the revised net premium ratio is less than 100 percent, the entity does not record an adjustment as of the transition date and the revised net premium ratio is applied to all future reporting periods unless an update is necessary in a future period. If the revised net premium ratio is greater than 100 percent, the entity records a transition adjustment to retained earnings to the extent that net premiums exceed gross premiums.

9. FinREC believes that if prior to adoption of FASB ASU 2018-12, an entity allocated premium deficiency liabilities to individual contracts or groups, the entity can retain its existing allocation methodology, provided the methodology meets the principles described in paragraph 6.

Comments should be received by February 10, 2020, 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.