# Working Draft:

## Targeted Improvements to Long-Duration Contracts Implementation Issue


**Issue #8:** Updating cash flow assumptions in the net premium ratio

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

1. For traditional and limited-payment long-duration insurance contracts, paragraphs 35-9(a) and 35-6 of FASB ASC 944-40 require entities to update actual experience and cash flow assumptions in the net premium model used to measure the liability for future policyholder benefits. Entities are required to both update actual experience and review cash flow assumptions for potential revision at least on an annual basis at the same time each year.

2. FinREC believes FASB ASC 944-40-35 does not require entities to perform the required annual review at the same time for every product or cohort within an entity, provided entities consider paragraph 9 below. That is, entities could elect specific pre-determined times in the year to perform the annual review by product or cohort and apply the timing on a consistent basis.

3. FASB 944-40-35-5 states,

   Assumptions shall be updated in subsequent accounting periods as follows to determine changes in the liability for future policy benefits:

   a. Cash flow assumptions (that is, the assumptions used to derive estimated cash flows, including the mortality, morbidity, termination, and expense assumptions referenced in paragraphs 944-40-30-11 through 30-15) shall be reviewed—and if there is a change, updated—on an annual basis, at the same time every year.
      1. Cash flow assumptions shall be updated in interim reporting periods if evidence suggests that cash flow assumptions should be revised.
      2. An insurance entity may make an entity-wide election not to update the expense assumption referenced in paragraph 944-40-30-15.

   b. The discount rate assumption referenced in paragraph 944-40-30-9 shall be updated for annual and interim reporting periods, as of the reporting date.

4. FASB 944-40-35-6 states,

   Actual experience shall be recognized in the period in which that experience arises. The liability for future policy benefits shall then be updated for actual experience at least on an annual basis as described in paragraph 944-

40-35-5(a) (and for limited-payment contracts, see paragraph 944-605-35-1B for guidance on updating any corresponding deferred profit liability). An insurance entity need not update the liability for future policy benefits for actual experience more often than on an annual basis, unless cash flow assumptions are updated as described in paragraph 944-40-35-5(a)(1).

5. FASB ASC 944-40-35-6A states**,**

   A related charge or credit to net income (see paragraph 944-40-45-4) or other comprehensive income as a result of updating assumptions at the level of aggregation at which reserves are calculated (that is, for a group of contracts) shall be determined as follows:

   a. Cash flow assumptions. Net premiums shall be updated for cash flow changes. An insurance entity shall update its estimate of cash flows expected over the entire life of a group of contracts using actual historical experience and updated future cash flow assumptions. An insurance entity shall recalculate net premiums by comparing the present value of actual historical benefits and related actual (if applicable) historical expenses plus updated remaining expected benefits and related expenses, less the liability carryover basis (if applicable), with the present value of actual historical gross premiums plus the updated remaining expected gross premiums (see Examples 6 and 7 in paragraphs 944-40-55-29H through 55-29U). The revised ratio of net premiums to gross premiums shall not exceed 100 percent (see paragraph 944-40-35-7A).
      1. Liability remeasurement gain or loss. The revised net premiums shall be used to derive an updated liability for future policy benefits as of the beginning of the current reporting period, discounted at the original (that is, contract issuance) discount rate. The updated liability for future policy benefits as of the beginning of the current reporting period shall then be compared with the carrying amount of the liability as of that date (that is, before the updating of cash flow assumptions) to determine the current period change in liability estimate (that is, the liability remeasurement gain or loss) to be recognized in net income for the current reporting period (see paragraph 944-40-45-4 for presentation requirements).
      2. Current-period benefit expense. The revised net premiums shall be applied as of the beginning of the current reporting period to derive the benefit expense for the current reporting period (see paragraph 944-40-45-4 for presentation requirements).
      3. Subsequent periods. In subsequent periods, the revised net premiums shall be used to measure the liability for future policy benefits, subject to future revisions.

   b. Discount rate assumptions. Net premiums shall not be updated for discount rate assumption changes.
      1. The difference between the updated carrying amount of the liability for future policy benefits (that is, the present value of future benefits and expenses less the present value of future net premiums based on updated cash flow assumptions) measured using the updated discount rate assumption and the original discount rate assumption shall be recognized directly to other comprehensive income (that is, on an immediate basis).
      2. The interest accretion rate shall remain the original discount rate used at contract issue date.

6. Entities should identify all cash flow assumptions applicable to the measurement of the liability for future policyholder benefits for traditional and limited-payment long-duration insurance contracts. As required by FASB ASC 944-40-35-5a(1), "cash flow assumptions shall be updated in interim reporting periods if evidence suggests that cash flow assumptions should be revised."

7. FinREC believes entities are not required to perform full experience studies outside of the regularly scheduled annual review, but should consider all information that is available in the interim period and have a reasonable basis to conclude all applicable assumptions are the entity's best estimate.

8. FASB ASC 944-40-35-6 similarly indicates that entities are not required to update actual experience in the net premium model outside of the regularly scheduled annual review. However, if one of the cash flow assumptions is updated in an interim period in accordance with FASB ASC 944-40-35-5a(1), an entity should also update actual experience. When actual experience is updated in an interim period, an entity should also assess whether cash flow assumptions should be updated in accordance with paragraph 7.

9. FinREC believes if evidence suggests the cash flow assumption(s) for one cohort require an update, the entity should consider whether the updated assumption(s) suggest the need for assumption updates to other cohorts that share the same or similar assumption(s). For example, changes to the mortality assumptions for one cohort may suggest a similar change is needed for other cohorts, provided there is a degree of overlap in the mortality assumptions.

10. When actual experience and cash flow assumptions are updated to determine a revised net premium ratio, FASB ASC 944-40-35-6A(a)1 requires remeasurement of the liability for future policyholder benefits as of the beginning of the current reporting period.

11. FinREC believes for entities that issue quarterly financial statements, the current reporting period refers to the beginning of the quarter in which the net premium ratio is revised. For all other entities, the beginning of the current reporting period could refer to the beginning of the quarter in which the net premium ratio is revised (if the entity prepares quarterly financial information), or could refer to the beginning of the year in which the net premium ratio is revised (if the entity only prepares annual financial statements).

12. FinREC believes that an entity's revision of the net premium ratio constitutes a change in estimate, and in accordance with FASB ASC 270-10-45-14, the effect of a change in accounting estimate should be accounted for in the period in which the change in estimate is made. That is, the remeasurement gain or loss is measured as of the beginning of the period (e.g. quarter) and that same amount remains unchanged in the financial statements in future year to date periods that include that quarter. If revisions are made to the net premium ratio in subsequent quarters, an additional remeasurement gain or loss would be calculated and presented for those quarters. For example, if a calendar-year entity that publishes quarterly financial statements made revisions in the first quarter, the beginning of the current reporting period would be January 1. If the entity made subsequent revisions in the third quarter, the beginning of the current reporting period for the subsequent revisions would be July 1. If no revisions were made in the second or fourth quarters, the year to date financial information reported during the third quarter and the annual financial information would report a remeasurement gain or loss equal to the sum of the remeasurement gains or losses for both the first and third quarters.

13. FASB ASC 944-40-45-4 requires entities to report the effect of the remeasured liability as of the beginning of the current reporting period as a separate component of total benefit expense (either parenthetically or as a separate line). Paragraphs 45-1 and 45-2 of FASB ASC 944-40 indicate this remeasurement gain or loss may be reported together with the remeasurement gain or loss related to death or other insurance benefits or annuitization benefits.

Comments should be received by April 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.