Insurance Expert Panel

Highlights of the December 19-20, 2018, Meetings

The Insurance Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the insurance industry to deliberate and come to agreement on key issues.

The Insurance Expert Panel met on December 19 for an Expert Panel meeting, and the morning of December 20 with the SEC Staff (the Staff).

The Expert Panel discussed the following topics:

1. **FASB ASU 2018-12: Targeted Improvements to Long-Duration Contracts, Implementation Issues:** The Expert Panel has identified and is in the process of discussing the following implementation issues
   - **a.** Claim Liabilities - Claim liabilities associated with long duration traditional insurance contracts, interaction with liability for future policy benefits**.**
   - b. Loss Recognition - Allocation of liability for future policy benefits to revised units of account at transition for blocks of business that had loss recognition prior to the transition date.
   - c. Market Risk Benefits – Scope (particularly general account products).
   - d. Market Risk Benefits - Market Risk Benefits - Considerations related to transition, including the use of hindsight.

     See discussion in the 11/15/2018 webcast: IN FOCUS: FASB Accounting Standards Update on Insurance, https://event.webcasts.com/starthere.jsp?ei=1214258&tp_key=80d55edf76
   - e. Market Risk Benefits – Considerations related to attributed fees as discussed in FASB ASC 944-40-30-19C.
   - f. Discount rate – Considerations related to use of a curve.
   - g. Discount rate – Transition considerations for limited payment contracts where a separate deferred profit liability is not recorded, and a breakeven discount rate was used in accordance with Chapter 7: Liabilities for Future Policy Benefits, of the 2018 AICPA Audit and Accounting Guide: Life and Health Insurance Entities.
   - h. Updating cash flow assumptions in the net premium ratio –
     - i. Clarification on what is meant by beginning of the current period in FASB ASC 944-40-35-6A(a)1.

       See discussion in the 11/15/2018 webcast: IN FOCUS: FASB Accounting Standards Update on Insurance, https://event.webcasts.com/starthere.jsp?ei=1214258&tp_key=80d55edf76
     - ii. Clarification on the assessment for updating cash flow assumptions and actuals in the net premium ratio.
   - i. DAC Amortization -
     - i. Considerations for evaluating whether the amortization on a constant-level basis for grouped contracts approximates straight-line amortization on an individual basis.

See discussion in the 11/15/2018 webcast: IN FOCUS: FASB Accounting Standards Update on Insurance,
https://event.webcasts.com/starthere.jsp?ei=1214258&tp_key=80d55edf76

ii. Interaction of cash flow assumption updates and DAC amortization assumption updates.
iii. Considerations for determining the "expected term of the contract" (as discussed in FASB ASC 944-30-35-3A).

j. Other Intangibles Generated in a Business Combination (i.e., Present value of future profits [PVFP], value of business acquired [VOBA]) – Considerations for determining the level of aggregation and discount rate to be used in the premium deficiency test for PVFP relating to traditional and limited-payment contracts.
k. Reinsurance - Considerations for application of FASB ASU 2018-12 to reinsurance contracts.
l. Impact of FASB ASU 2018-12 on various shadow adjustments.
m. Presentation – Clarification of items within other comprehensive income as discussed in FASB ASC 220-10-45-10A(m) and 45-10A(m).
n. Transition –
   i. Considerations for determining the balance for future policy benefits as discussed in FASB ASC 944-40-65-2C and 65-2D.
   ii. Changes in method for balances currently amortized using amortization methods similar to DAC.

The status of FASB ASU 2018-12 implementation issues can be found on the insurance expert panel webpage at:
https://www.aicpa.org/interestareas/frc/industryinsights/long-duration-insurance-accounting-issues.html

2. **Statutory Practice Issues:** The Expert Panel discussed several issues that are currently on the NAIC's agenda:
   a. **SSAP No. 108: Derivatives Hedging Variable Annuity Guarantees**. The SSAP prescribes guidance for derivatives that hedge interest rate risk of variable annuity guarantees, with an effective date of January 1, 2020, and early adoption permitted as of January 1, 2019
   b. **SSAP No. 101: Income Taxes.** It was noted that questions had been submitted to the NAIC by Interested Parties regarding the impact of the Tax Cuts and Jobs Act on reversal patterns of deferred tax items for statutory accounting purposes.
   c. **FASB ASU 2018-12: Targeted Improvements to the Accounting for Long-Duration Contracts Issued by Insurance Companies:** The NAIC has started its process of reviewing FASB ASU 2018-12 for applicability to Statutory accounting. The regulators stated that they anticipate rejecting this standard for statutory accounting
   d. **FASB ASU 2016-13: Financial Instruments—Measurement of Credit Losses on Financial Instruments:** The NAIC is in the process of reviewing FASB ASU 2016-13 for applicability to Statutory accounting.
   e. **Reinsurance** – The NAIC adopted revisions to SSAP No. 62R, Property and Casualty Reinsurance to incorporate U.S. GAAP guidance from EITF 93-6 on retrospectively rated reinsurance contracts directly into the standard versus in corporation by reference, which is effective January 1, 2019. The NAIC's project to consider possible changes to SSAP 61R, Life, Deposit, and Accident and Health Reinsurance, is still on-going.
   f. **"Liquidity Disclosures"** – The NAIC has adopted for 2019 Life annual statement significantly expanded Analysis of Operations and Analysis of Reserves schedules, which are expected to require significant implementation effort by many life insurers.

3. **AICPA Auditor Reporting Task Force –** The AICPA Auditing Standards Board (ASB)'s Auditor Reporting Task Force continues to discuss potential changes to AU-C 800, *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*, to converge with changes made to the related international standard. Among the considerations is whether to introduce the notion of a compliance framework as permitted by international standards which would require only that the financial statements be presented in accordance with the special purpose framework as opposed to a fair presentation framework in which the auditor is required to consider whether disclosures beyond those required by the framework are necessary for the financial statements to be fairly presented. Such a change might eliminate the need for a dual opinion on the statutory financial statements (an opinion on GAAP and an opinion on the regulatory basis).

   The ASB will continue discussing this project at its January 2019 meeting. Meeting materials can be found on the ASB webpage at:

https://www.aicpa.org/research/standards/auditattest/asb/201901-asb-meeting-agenda-materials.html

4. **American Academy of Actuaries –** The Expert Panel also had a call with members of the American Academy of Actuaries and discussed the following FASB ASU 2018-12 implementation issues:
    a. Updating Cash Flow Assumptions
    b. DAC Amortization Methods
    c. Market Risk Benefits
    d. Unit of Account
    e. Discount Rate
    f. VOBA - Premium Deficiency:
    g. Claim Liabilities

On December 20, 2018 the Staff discussed the following topics of interest with the Expert Panel:

1. **Disclosure Observations:**

    a. **FASB ASU 2015-09: Disclosures about Short-Duration Contracts** – The Staff discussed observations related to disclosures required by FASB ASU 2015-09.

    As noted at the December 2017 meeting, the Staff reminded the Expert Panel that the objective of these disclosures as explained in BC2 of ASU 2015-09, "…to increase transparency of significant estimates made in measuring the liability for unpaid claims and claim adjustment expenses, improve comparability by requiring consistent disclosure of information, and provide financial statement users with information to facilitate analysis of the amount, timing, and uncertainty of cash flows arising from contracts issued by insurance entities and the development of loss reserve estimates."

    The minutes from the December 2017 discussions with the Staff can be found on the Expert Panel webpage at:
    https://www.aicpa.org/content/dam/aicpa/interestareas/frc/industryinsights/downloadabledocuments/ins/ins-ep-minutes/ins-ep-december-2017-meeting.pdf

    i. Registrants should ensure the analysis of reserve development provided in the notes to the financial statements and in MD&A is consistent with the data depicted in the loss development tables presented in the loss development tables required by the ASU.

    ii. **Level of Disaggregation:** The Staff expects insurers to provide sufficient information to ensure that users are able to understand estimates for the liability for unpaid claims and claim adjustment expenses. During 2018, a common comment letter theme was the need for further disaggregation in the loss development tables. Some examples where further disaggregation of the loss development table was requested include situations where the registrant provided; one combined table with short-tailed insurance business, such as automobile coverage, and long-tailed insurance, such as workers compensation, or depending on materiality, combining automobile liability coverage (longer-tailed) and automobile physical damage coverage (shorter-tailed).

    The Staff also indicated that registrants should consider the need for disclosure of the reason for inconsistencies between prior year development in the 3 year rollforward disclosure of the liability for unpaid claims and claim adjustment expenses, as required in FASB ASC 944-40-50-3 and the development depicted in the 10-year disaggregated tables.

    iii. **Acquisitions**: The Staff reiterated comments made to the Expert Panel at the November 2016 meetings related to presentation of acquisitions in the loss development tables:

    > The Staff noted that a retrospective approach would achieve the disclosure objectives of the ASU by presenting all relevant historical information for all periods presented. In this approach an acquirer would include the acquiree's historical incurred and paid accident year claim information in its claims development tables and related disclosures. In applying a retrospective approach, it would be appropriate to either present the incurred and paid claim information of the acquiree separately, or combined with the claims development information of the acquirer using the disaggregation principle as required by the ASU. In contrast, the SEC staff noted that a prospective presentation of an acquired business that depicts the year of acquisition as the accident year for all liabilities acquired

in the acquisition would not be consistent with the ASU's definition of accident year. The SEC staff also noted that a prospective presentation that commingles the liabilities acquired in the acquisition with the registrant's existing business, even if they depict the acquired liabilities by accident year, would not be consistent with the disaggregation and meaningful trend analysis requirements of the ASU.

The Staff did note that a prospective approach where the incurred and paid accident year claim information of the acquiree is presented separately from the acquirer as of the acquisition date and in subsequent periods in a separate table or tables as appropriate could be deemed to meet the disclosure objectives of the ASU. Under this method, the acquired liabilities as of the acquisition date would be presented in the fiscal year that includes the acquisition date by individual accident year in the incurred section of a table, with subsequent activity presented separately in the incurred and paid sections of that table. Acquired liabilities and subsequent development related to them should be presented separately from the acquirer's information.

The minutes from the November 2016 discussions with the Staff can be found on the Expert Panel webpage at: https://www.aicpa.org/content/dam/aicpa/interestareas/frc/industryinsights/downloadabledocuments/ins/ins-ep-minutes/ins-ep-meeting-highlights-archive.pdf

iv. **Assumed Reinsurance**: The Staff reiterated that if assumed reinsurance is presented using a prospective approach, the information for the assumed reinsurance should be presented in a separate table or tables as appropriate.

v. **Ceded Reinsurance**: The disclosures in FASB ASC 944-40-50-4B and 50-4G are required to be presented net of reinsurance. That is, for reinsurance entered into the current period that provides coverage for claims relating to prior accident years, the prior year columns should be adjusted to include the impact of the reinsurance contract entered into in the current year. The Staff noted that this retrospective presentation in the loss development tables may be difficult for certain types of reinsurance, for example a retroactive contract that covers multiple lines of business spanning multiple tables with one aggregate attachment point. The Staff welcomes dialogue with registrants to determine the best method for fulfilling the objective of the disclosures for this type of reinsurance.

vi. **Loss Reserve Development**: The Staff mentioned that it is looking for improved disclosures related to the explanation of the underlying causes of changes in loss development. Registrants should provide explanation of the <u>ultimate</u> underlying cause of favorable or unfavorable development, not simply mentioning the particular accident years and lines of business impacted.

b. **Common Comments on Filing Reviews** – The Staff discussed miscellaneous comments that had been provided to insurers but not the resolution:

i. Investments:

1. Equity Method Investments - Total earnings on equity method investments should be disclosed as required by Rule 7-04 (10).
2. Debt Securities
   a. Disclosures on debt securities (classification) should be disaggregated to provide useful information. An example provided was to disaggregate by economic characteristics.
   b. Disclosures should explain why no other than temporary impairments are recorded when trends indicate unrealized loss on debt securities are increasing.

ii. Business Combinations – The Staff provided a reminder that settlement of contingent consideration that is accounted for as a component of equity under FASB ASC 805-30-35-1(a), should be recorded in equity and not a gain or loss in the statement of operations.

iii. **Contractual Obligations Table** – The Staff noted that there is diversity in practice by insurance entities on presentation in the contractual obligations table. It was noted that some insurers include only future projected benefits/outflows, while others include future projected outflows and projected premium receipts/inflows that are related to the obligations presented in the table. The Staff and Expert Panel planned to have further discussions.

On February 15, 2019, the Expert Panel provided insight to the Staff into the diversity in practice, why amounts in the table may not agree to the balance sheet in net presentations, and implementation issues or other factors impacting a switch from net presentation to a gross presentation.

On March 21, 2019, the Staff indicated that based on its understanding of the feedback provided, it would not pursue further at this time net versus gross presentation of the payment due for the liability for future policy benefits in the contractual obligations table. In these circumstances, footnotes to the table should clearly articulate the basis of presentation, describe contract terms that impact the timing of net cash flows, and provide any other pertinent data necessary for an understanding of the timing and amount of the company's specified contractual obligations. The Staff reserved the right to reconsider this issue as it continues to evaluate disclosure as well as the effects of standard setting, such as FASB ASU 2018-12

2. **FASB ASU 2018-12: Targeted Improvements to Long-Duration Contracts:** The Expert Panel provided the Staff with an overview of the key accounting changes to long-duration contracts under FASB ASU 2018-12 in the following areas:
    a. Traditional & Limited-Pay Contracts
        i. Updating of Assumptions
        ii. Cash Flow Assumptions
        iii. Discount Rate Assumptions
    b. Universal Life-Type Contracts
    c. Market Risk Benefits
    d. Deferred Acquisition Costs
    e. Presentation and Disclosure
    f. Effective Date and Implementation Challenges

    The Expert Panel also provided the Staff with an overview of the potential challenges to registrants adopting FASB ASU 2018-12 if the SEC 5 Year Table (SEC Regulation S-K, Item 301, "Selected Financial Data.") is required to be applied to all five years at the year of adoption (i.e., if the registrant is required to apply it to years preceding what is presented in the registrant's primary financial statements in the year of adoption). The Staff indicated that they would consider the information provided in deciding whether to provide any relief from the Item 301 requirements.

3. **Accounting Standards: The Expert Panel provided the Staff with an overview and potential impacts to insurance entities, of the following accounting standard:**
    a. FASB ASU 2016-13: Financial Instruments—Measurement of Credit Losses on Financial Instruments.