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Accounting Journal Entry

Long-Duration Insurance Contracts — FASB Decides on Transition Requirements and Votes to Reexpose Proposal

March 25, 2016 — At its meeting this week, the FASB discussed its targeted improvements for accounting for long-duration insurance contracts and made tentative decisions about the transition methods for (1) the liability for future policy benefits, (2) market risk benefits, and (3) deferred acquisition costs (DAC). The Board also tentatively approved certain disclosures related to transition and voted to direct its staff to draft a proposed Accounting Standards Update (ASU) reflecting its tentative decisions in the project.

Transition Methods

Liability for Future Policy Benefits

The Board tentatively decided that an entity should apply the guidance on determining the liability for future policy benefits by using the following transition approach as of the "transition date" (defined as "the beginning of the earliest period presented"):[1]

1. Retrospectively to all prior periods using actual historical information at the level at which reserves are calculated.

    a. If actual historical information covering the entire contract period is not available at the level at which reserves are calculated, an insurance entity would be required to use estimates for those periods in which actual historical information is not available. The historical information should be derived from objective information that is reasonably available.

    b. An insurance entity should recognize in accumulated other comprehensive income the cumulative effect of changes in discount rates between the contract inception date and transition date.

2. If it is impracticable to apply the guidance retrospectively to all prior periods at the level at which reserves are calculated, an insurance entity should apply the guidance to in-force contracts on the basis of their existing carrying amounts at the transition date and updated future assumptions. The opening retained earnings balance should be adjusted to the extent that the net premium ratio exceeds 100 percent. The transition date should be considered the contract inception date for purposes of subsequent adjustments.

Market Risk Benefits

The Board tentatively decided that an entity should measure market risk benefits at fair value as of the transition date (as defined). An entity should record the transition adjustment as follows: (1) the "cumulative effect of changes in an entity's own credit risk between [the] contract inception date and [the] transition date should be recognized in accumulated other comprehensive income" and (2) the "difference between fair value and carrying value at the transition date, excluding the amount in (1), should be adjusted to opening retained earnings."

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[1] Quoted text is from the tentative decisions posted on the FASB's Web site.

Deferred Acquisition Costs

The Board tentatively decided that an entity should apply the proposed guidance on DAC "as of the transition date on the basis of the existing carrying amounts at that date, adjusted for the removal of any related amounts in accumulated other comprehensive income."

During the meeting, the staff shared feedback it received on the Board's tentative decisions about DAC related to (1) the approach for changing the carrying amount of the DAC (or assets similarly amortized, such as the value of business acquired) as a result of a change in circumstances, and (2) the amortization of future renewal costs. The staff indicated that it will clarify these topics in the Basis for Conclusions of the proposed guidance, and the Board did not object to this approach.

Transition Disclosures

The Board tentatively approved certain transition disclosure requirements for the year of adoption. Under those requirements, an entity would disclose:

- The information required by ASC 250-10-50-1 through 50-3[2] regarding a change in accounting principle; however, the entity should provide such disclosures at a level of disaggregation that is consistent with the level it will use for required recurring disclosures.
- The portion of the liability for future policy benefits and market risk benefits that is not determined under the retrospective approach because of impracticability.
- "Qualitative and quantitative information about transition adjustments related to (a) a net premium ratio exceeding 100 percent or (b) the establishment of an additional liability for a nontraditional contract" (if applicable).

Next Steps

The staff will draft a proposed ASU soliciting comments on the Board's tentative decisions for the long-duration insurance contracts project. The FASB expects to issue the proposal later this year.

[2] FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*.