

FASB In Focus

ACCOUNTING STANDARDS UPDATE NO. 2018-12

Targeted Improvements to the Accounting for Long-Duration Contracts Issued by Insurance Companies

On August 15, 2018, the Financial Accounting Standards Board ([FASB](#)) issued an Accounting Standards Update ([ASU](#)) to improve financial reporting for insurance companies that issue long-duration contracts such as life insurance and annuities.

The objective of the ASU is to improve, simplify, and enhance the financial reporting of long-duration contracts by providing financial statement users with useful information in a timely and transparent manner.

Why Is the FASB Making Targeted Improvements to the Accounting for Long-Duration Contracts?

Ten years ago, the FASB undertook a comprehensive project with the International Accounting Standards Board to improve the accounting for insurance contracts.

In 2013, the FASB issued proposed Accounting Standards Update, Insurance Contracts (Topic 834), which introduced new accounting models and qualitative and quantitative disclosures.

The feedback received from investors, analysts, insurance companies, and other stakeholders overwhelmingly supported making targeted improvements to the existing insurance accounting model (instead of introducing a completely new and complex accounting model) and limiting the scope of insurance accounting to insurance companies.

What Kind of Outreach Did the FASB Undertake?

Over the past 10 years, the FASB has conducted extensive outreach activities and received significant input from a wide variety of stakeholders. The outreach activities undertaken by the FASB are depicted below:

Outreach with Stakeholders

More than
150 meetings
with users



More than
450 comment letters
from users, preparers, auditors,
industry groups, and others



**13 public
round tables**
hosted or attended
by the Board or staff



13 group meetings
with 60 users



14 conferences
with more than 150 users



More than
250 meetings
with preparers, auditors,
industry groups, and others



Who Will Be Affected by the Changes?

The changes will apply to insurance companies that issue long-duration contracts such as life insurance, disability income, long-term care, and annuities. The changes do not apply to policyholders.

How Will the Changes Improve Insurance Accounting?

The changes will result in the following improvements:

1. **A more current measure of the insurance liability.** The liability for future policy benefits for traditional and limited-payment contracts will be regularly refined for actual experience and updated assumptions about the future. Also, the liability will be discounted at an upper-medium grade (low-credit-risk) fixed-income instrument yield that reflects the characteristics of the liability rather than the invested assets supporting the liability.
 - a. Cash flow assumptions will be reviewed—and if there

is a change, updated—at least annually, with changes reflected separately in net income.

- b. Discount rate assumptions will be updated at each

reporting date, with changes reflected in other comprehensive income.

2. **A more uniform and current, market-based measure of market-based options or guarantees.** Market risk benefits will be measured at fair value, with the effect of changes in the insurance entity's credit risk recognized in other comprehensive income.
3. **Simplified amortization of deferred acquisition costs.** Deferred acquisition costs will be amortized on a constant-level basis over the expected life of the contract. As a result, the expense pattern will be more easily

New ASU: Overview of Changes

AREA OF FOCUS	TARGET	IMPROVEMENT
Liability for future policy benefits	Original assumptions remain "locked"	Assumptions periodically reviewed or updated, increasing relevance
	Discount rate is the insurer's expected investment yield	Discount rate is upper-medium grade (low-credit-risk) fixed-income instrument yield
Market risk benefits	Two measurement models	One measurement model, improving uniformity
Deferred acquisition costs	Complex amortization	Simplified amortization, increasing understandability
Disclosures	Limited disclosures	Enhanced disclosures

Effect of a change in expected future cash flows (traditional and limited-payment contracts)

EXPECTED FUTURE CASH FLOW CHANGE	FINANCIAL STATEMENT IMPACT
Favorable	<ul style="list-style-type: none"> • Lower insurance liability • Higher profit emergence
Unfavorable	<ul style="list-style-type: none"> • Higher insurance liability • Lower profit emergence

predictable and will no longer fluctuate in tandem with an insurance company's investment or underwriting performance. Also, deferred acquisition costs will not be subject to impairment testing; instead, deferred costs will be amortized as long as the related contracts remain outstanding.

4. **Enhanced disclosures.** Several new disclosures will be required, including liability rollforwards and information about significant inputs, judgments, assumptions and methods used in measurement.

When Will the Changes Be Effective?

For calendar-year public business entities, the changes are effective at the beginning of 2021. For all other calendar-year entities, the changes are effective at the end of 2022. Early application is permitted.

What about Transition?

Changes to the liability for future policy benefits and deferred acquisition costs will apply to all outstanding contracts on the basis of their existing carrying amounts at the beginning of the earliest period presented, adjusted for the removal of any related amounts in accumulated other comprehensive income. An insurance company will have the option to apply the changes

What is a Market Risk Benefit?

A benefit offered by an insurer that protects a contract holder from capital market risk (for example, investment losses due to market downturns)

CURRENT: Two measurement models



IMPROVEMENT: One measurement model



retrospectively (with a cumulative catch-up adjustment to the opening balance of retained earnings), using actual historical experience information as of contract inception. This option will be elected at the issue-year contract aggregation level and applied to all contract groups for that issue year and all subsequent issue years.

Market risk benefits will be measured at fair value at the beginning of the earliest period presented. A cumulative catch-up adjustment will be recognized in two pieces:

1. The cumulative effect of the effect of changes in the insurance entity's credit risk will be

recognized in accumulated other comprehensive income.

2. The difference between fair value and carrying value, excluding the effect of credit risk changes, will be recognized in the opening balance of retained earnings.

**For more information
about the project, please
visit the FASB's website
at www.fasb.org.**